Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

—against—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner Touche Ross & Co. ("Touche Ross"), defendant-appellee below, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered herein on April 21, 1978.

OPINIONS BELOW

The opinion of the Court of Appeals (1a-35a[1]) is not yet officially reported, and is unofficially reported at [Current Binder] FED. SEC. L. REP. (CCH) ¶ 96,404. The opinion of the District Court (40a-58a) is reported at 428 F.Supp. 483.

[1]Numerals followed by the letter "a" refer to pages of the Appendix to this Petition.

JURISDICTION

The judgment of the Court of Appeals (36a-37a) was entered on April 21, 1978. The Court of Appeals denied Touche Ross' timely petition for rehearing and suggestion for rehearing *en banc* on July 7, 1978 (38a-39a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Does Section 17(a) of the Securities Exchange Act of 1934, which requires the filing of certain reports by a securities brokerage firm, create in favor of customers of the brokerage firm an implied private right of action against accountants who audited such reports for damages resulting from misstatements therein, even though Section 18(a) thereof already expressly provides a limited private damage remedy for such misstatements, and even though the implied remedy under Section 17(a) would be broader than the limited express remedy of Section 18(a)?

2. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is a Trustee liquidating the business of the brokerage firm pursuant to the Securities Investor Protection Act of 1970 empowered to assert such implied right of action on behalf of customers whose property he is unable to return in the course of the liquidation?

3. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is Securities Investor Protection Corporation, upon advancing funds to the Trustee for the payment of claims of customers pursuant to the Securities Investor Protection Act of 1970, subrogated to such implied right of action of such customers, even though the Act expressly provides (in Section 6(f)(1)) only that Securities Investor Protection

Corporation is subrogated, upon the advancement of such funds, to the customers' rights against the estate of the brokerage firm, and not to the customers' rights against third-parties such as accountants?

STATUTES AND RULES INVOLVED

Sections 17(a) and 18(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78q(a), 78r(a), and Rule 17a-5 of the Securities and Exchange Commission (the "SEC"), 17 C.F.R. § 240.17a-5, and Sections 6(b)(1) and 6(f)(1) of the Securities Investor Protection Act of 1970 ("SIPA"), 15 U.S.C. §§ 78fff(b)(1), 78fff(f)(1), all as in effect in 1972, are set forth in the Appendix hereto (59a-70a).

STATEMENT OF THE CASE

The federal claims on the basis of which respondents (plaintiffs-appellants below) here seek access to the federal courts are based solely upon Section 17(a) of the 1934 Act, which is one of the various reporting provisions of the 1934 Act (see p. 12 n.7, *infra*) and requires the filing by broker-dealers of "reports" prescribed by the SEC. Consequently, since respondents concededly are unable to assert the express remedy provided in Section 18(a) of the 1934 Act for misstatements in Section 17(a) reports, this action presents, in the words of the Court of Appeals majority, the "question whether [an implied] private cause of action exists under section 17[a] . . . against accountants who prepare misleading statements of a broker's financial affairs, and if so, who may maintain such an action" (2a-3a). Over a vigorous and scholarly dissent, the Court of Appeals majority held, in the first such holding in the 44 years since enactment of Section 17(a), that it does create such an implied private right of action.

A. The Facts

This action arises from the liquidation pursuant to SIPA of the business of Weis Securities, Inc. ("Weis"), a

defunct brokerage firm, and seeks to recover for respondents from Touche Ross aggregate damages of $65,000,000 allegedly resulting from the liquidation. Respondent Edward S. Redington (the "Trustee") is the Trustee appointed pursuant to SIPA for the liquidation. Respondent Securities Investor Protection Corporation ("SIPC") advanced, in accordance with the provisions of SIPA, by which it was created and pursuant to which it acts, funds to the Trustee to pay the claims of certain customers of Weis in the liquidation. Touche Ross is a firm of certified public accountants which audited financial reports (the "1972 Weis financial reports") of Weis for periods ending May 26, 1972, approximately a year before the Weis collapse.

The Trustee and SIPC commenced this action in the United States District Court for the Southern District of New York in April 1976, nearly a year after they had commenced an almost identical action (the "State Court Action") against Touche Ross in the New York state courts. The State Court Action, which is presently pending, is based upon the same factual allegations, asserts essentially the same claims and seeks the same aggregate damages of $65,000,000 as does this federal action.[2]

[2]The State Court Action was commenced in July 1975, and is entitled *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Sup. Ct. N.Y. County, Index No. 13996/76). The only material difference in the two actions is the addition in the complaint in this action of the few allegations deemed by respondents to be necessary to assert their Section 17(a) claims—*i.e.*, the few allegations by which the Trustee and SIPC seek to "federalize" what are essentially nothing more than common law claims of accountants' negligence and malpractice. As the Court of Appeals majority put it, "[t]he common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the [19]34 Act were omitted. Five of the Trustee's six present 'causes of action' appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims" (5a).

According to the complaint, the allegations of which are accepted for purposes of this Petition (see also 4a[n. 4]), Weis was a broker-dealer in securities registered with the SEC and a member of the New York Stock Exchange (the "Exchange"). As the result of investigations by the SEC and the Exchange in April and May 1973, and upon the application of the SEC and SIPC, the United States District Court for the Southern District of New York on May 30, 1973, ordered the liquidation of Weis pursuant to SIPA, and appointed the Trustee.

Certain officers of Weis had misstated the financial condition and results of operations of Weis in the 1972 Weis financial reports, which were required to be filed with regulatory authorities pursuant to Section 17(a) of the 1934 Act, and had made it appear therein that Weis had pre-tax earnings for the fiscal year of $1,700,000, whereas Weis actually had suffered losses in excess of $1,500,000. According to the Trustee and SIPC, Touche Ross performed its audit of the 1972 Weis financial reports in a "negligent, reckless, careless, unskilled and grossly negligent manner", and therefore not only failed to discover the misstatements but also improperly certified that the 1972 Weis financial reports fairly and accurately presented the financial condition of Weis in accordance with generally accepted accounting principles. The Trustee and SIPC also contend that if Touche Ross had discovered the misstatements in the 1972 Weis financial reports, Weis' declining financial position and the waste of its assets would have been revealed earlier, remedial action such as a change in the Weis management or merger with another firm could have been taken, the forced liquidation of Weis could have been averted or its adverse consequences reduced, and the losses here sued for would not have occurred.

On the basis of the foregoing, the Trustee seeks (either on behalf of Weis itself or for the customers of

Weis) to recover damages of $51,000,000, alleging (i) a federal claim that Touche Ross' deficient audit of the 1972 Weis financial reports violated Section 17(a) of the 1934 Act, and (ii) common law claims of accountants' negligence and malpractice, breach of contract and breach of warranty. SIPC seeks to recover (either in its own right on account of funds it advanced to the Trustee or as subrogee of the customers for whose claims it advanced such funds) damages of $14,000,000, alleging (i) federal claims of violation of Section 17(a) by Touche Ross, and (ii) common law claims of accountants' negligence and malpractice. As noted (p. 4 n.2, *supra*), the federal claims of both the Trustee and SIPC are essentially nothing more than the restatement of their common law claims—basically for accountants' negligence and malpractice—together with the additional conclusory allegations that Touche Ross' conduct also violated Section 17(a).

B. The Dismissal of This Action By The District Court

In the District Court, Touche Ross moved to dismiss this action on the grounds that (i) the federal claims of the Trustee and SIPC, which are based solely on Section 17(a) of the 1934 Act, fail to state a claim upon which relief can be granted because Section 17(a) does not create any implied private right of action, and (ii) subject matter jurisdiction of their common law claims is lacking.[3] The District Court granted the motion and

[3]The District Court had jurisdiction of the Section 17(a) claims by virtue of Section 27 of the 1934 Act. Jurisdiction of the common law claims was alleged to exist by reason of pendent jurisdiction, as well as (for the Trustee) jurisdiction under SIPA and the Bankruptcy Act and (for SIPC) diversity jurisdiction. Touche Ross' motion asserted, and the District Court held, that pendent jurisdiction was lacking because the federal claims under Section 17(a) fail to state a claim upon which relief can be granted, and that subject matter jurisdiction of the common law claims did not exist on any of the other alleged bases.

dismissed the action (40a-58a).[4]

In holding that no private right of action can be implied under Section 17(a), the District Court reasoned that, while there was no explicit statement of legislative intent with respect thereto, the grant in Section 18(a) of an express and carefully limited remedy for misstatements in Section 17(a) reports, as well as for misstatements in reports filed pursuant to other reporting provisions of the 1934 Act, only to purchasers or sellers of securities in reliance upon such misstatements, "strongly suggest[s] a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18" (49a-50a). The District Court also concluded that it is not "necessary to imply a civil liability under Section 17 in order to enforce its provisions" (51a). The District Court explicitly followed recent decisions of this Court which recognize that it would be anamolous and improper to impute to Congress an intention to permit an implied remedy under the 1934 Act which would be broader than the express statutory remedies specifically provided, and which emphasize that creation by judicial interpretation of an implied private damage remedy is proper only if it is necessary to effectuate Congress' goals. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 734, 736 (1975); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25-26 (1977). The District Court also followed a decision of the Court of Appeals for the Third Circuit, *In re Penn Central Securities Litigation*, 494 F.2d 528 (3d Cir. 1974), and other district court decisions, which hold

[4]Touche Ross' motion also sought dismissal of certain of the common law claims for failure to state a claim upon which relief can be granted. Alternatively, the motion sought a stay of this action pending determination of the State Court Action. It was unnecessary for the District Court to reach, and it did not consider, those issues.

that other reporting provisions of the 1934 Act do not themselves, in view of the express remedy provided by Section 18(a) and its careful limitation by Congress to certain purchasers or sellers of securities, create any implied private rights of action.

C. The Decision Of The Court Of Appeals

A divided Court of Appeals (Lumbard and Timbers, CJJ., constituting the majority), over a vigorous and well-reasoned dissent (Mulligan, CJ.), reversed the District Court and remanded for further proceedings. The Court of Appeals majority held that customers of a brokerage firm have an implied private right of action under Section 17(a) against accountants for misstatements in audited reports filed pursuant thereto (6a-12a), although it expressly declined to set forth "the appropriate standard for accountant liability in [such] actions" (15).[5] Moreover, the majority, while recognizing that neither the Trustee on behalf of Weis nor SIPC in its own right has any right of action under Section 17(a) because they are not within any class protected thereby, also held that the Trustee, as "bailee" of certain customers' property, and SIPC, as "subrogee" of customers for the payment of whose claims it has advanced funds, may assert such right of action (12a-15a).

Judge Mulligan, in dissent, would have affirmed the order of the District Court. He concluded that there is no implied private right of action under Section 17(a) (20a-33a), and that, even if there were, the Trustee and SIPC are not proper parties to assert such right of action to recover customers' damages (33a-35a).

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[5]The majority did not disturb, and expressed no opinion as to, the District Court's holding that, absent pendent jurisdiction, there is no other basis for subject matter jurisdiction of the common law claims (3a [n.3]). The majority, even though it permitted the Trustee and SIPC to assert federal claims under Section 17(a), also expressly declined to determine whether pendent jurisdiction over the common law claims should be exercised (15a).

REASONS FOR GRANTING THE WRIT

The holding of the Court of Appeals majority that Section 17(a) provides an implied private right of action for brokerage firm customers who are not purchasers or sellers of securities, and to whom the express remedy set forth in Section 18(a) thus is not available, is erroneous and conflicts in principle with decisions of this Court and the Third Circuit. As shown hereinbelow (pp. 10-25, *infra*), that holding—which, as pointed out in Judge Mulligan's dissent, "goes beyond statutory construction; it amounts instead to judicial legislation" (27a)—(i) is based upon the majority's misapprehension of the significance of the statutory scheme which provides in the 1934 Act both a reporting requirement (Section 17(a)) and a limited *express* remedy for violations thereof (Section 18(a)), and (ii) conflicts with the principles established in this Court's decisions that, where an express remedy is provided for violation of a statute, the statute does not, in the absence of clear evidence of contrary legislative intent, give rise to another and broader implied remedy, and that under the 1934 Act specifically it is improper to imply remedies which are broader than the express statutory remedies provided therein or which are not necessary to effectuate Congress' goals, and (iii) conflicts in principle with a decision of the Third Circuit that, by reason of the express remedy in Section 18(a) for reporting violations, other reporting provisions of the 1934 Act do not themselves give rise to any implied rights of action.[6]

The majority's holding that the Trustee and SIPC may assert, as "bailee" and "subrogee", respectively, the Section 17(a) claims of certain Weis customers against Touche Ross also is erroneous. As shown hereinbelow (pp. 25-29, *infra*), that holding is based upon the

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[6]As noted by the District Court (48a), the question of whether there is an implied private right of action under Section 17(a) expressly was left undecided in this Court's decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194 n.13 (1976).

majority's misapprehension of the statutory context of the grant of powers to the Trustee, and of subrogation rights to SIPC, and conflicts in principle with decisions of this Court.

Finally, it is shown hereinbelow (pp. 29-34, *infra*) that the questions raised by the majority's decision and by this Petition are important to the administration of the federal securities laws and should be decided by this Court.

I

The Holding By The Court of Appeals Majority That, Despite The Express Remedy In Section 18(a), Section 17(a) Creates An Implied Private Right Of Action Conflicts With This Court's Decisions That, Where An Express Remedy Is Provided For Violation of A Statute, The Statute Does Not, Absent Clear Contrary Evidence Of Legislative Intent, Give Rise To Another And Broader Implied Remedy

The Court of Appeals majority bases its conclusion that a private right of action may be implied under Section 17(a) upon a purported consideration of the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975) (6a, 7a-11a). However, as Judge Mulligan notes in his dissent (21a, 23a), *Cort* itself carefully restricted the application of those factors to determination of "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added), 422 U.S. at 78, a restriction which was again emphasized in *Piper* v. *Chris-Craft Industries, Inc., supra*, 430 U.S. at 37. As demonstrated in this Point I, this action does not present a situation where (as in *Cort*) a remedy is sought to be implied for violation of a statute as to which no express private remedy whatsoever is provided, but instead involves a statutory scheme in which Congress already expressly has provided both its desired statutory requirement (Section 17(a)) and the remedy (Section 18(a)) it thought necessary and appropriate for violations of that

requirement. Consequently, the controlling decisions are *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("*Amtrak*"), and *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975), which establish the principle that, absent clear contrary evidence of legislative intent, a remedy is not to be implied from a statutory provision for which a limited express remedy already is provided; *Blue Chip Stamps* v. *Manor Drug Stores, supra,* which recognizes the impropriety of implying broader remedies under the 1934 Act than the express statutory remedies specifically provided therein; and *Piper* v. *Chris-Craft Industries, Inc., supra,* which holds that a private right of action is not to be implied under the 1934 Act unless it is "necessary" to effectuate Congress' goals. Since there is, as even the Court of Appeals majority concedes (9a), no evidence of any Congressional intent to create an implied private right of action under Section 17(a), *Amtrak, Barbour,* and *Blue Chip Stamps* require a holding that Section 17(a) does not create any implied private right of action, and the contrary holding of the majority conflicts with those decisions. Moreover, since implication of such a private right of action is not, and was not considered by Congress to be, "necessary" to effectuate the goals of Section 17(a), *Piper* also requires a holding that there is no such implied right of action, and the contrary holding of the majority also conflicts therewith.

A. The Statutory Scheme Of The 1934 Act, Analyzed In Light Of This Court's Decisions In *Amtrak, Barbour, Blue Chip Stamps* And *Piper,* Demonstrates A Clear Congressional Intent That The Express Remedy Provided By Section 18(a) Be The Sole Remedy For Section 17(a) Violations

1. THE REPORTING REQUIREMENTS OF SECTION 17(a) AND RULE 17a-5, AND THE EXPRESS REMEDY PROVIDED IN SECTION 18(a) FOR MISLEADING REPORTS.—As this Court

recently has emphasized in cases arising under the 1934 Act, "[t]he starting point in every case involving construction of a statute is the language itself". *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *Piper* v. *Chris-Craft Industries, Inc., supra*, 430 U.S. at 24; *Ernst & Ernst* v. *Hochfelder, supra*, 425 U.S. at 197; *Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 756 (Powell, J., concurring).

Section 17(a), as in effect during 1972 when Touche Ross audited the 1972 Weis financial reports, required broker-dealers such as Weis to "make such *reports* as the [SEC] by its rules and regulations may prescribe" (emphasis added). 15 U.S.C. § 78q(a).[7] SEC Rule 17a-5, implementing Section 17(a), required that broker-dealers "file reports of financial condition containing the information required by Form X-17A-5 . . . within each calendar year". 17 C.F.R. § 240.17a-5(a)(2) (1972).

Section 18 is entitled "Liability For Misleading Statements". 15 U.S.C. § 78r. Section 18(a) provides an express damage remedy for misstatements "in any . . . *report*, or document filed pursuant to [the 1934 Act] or any rule or regulation thereunder" to persons "who, in

[7]Section 17(a) is only one of the sections of the 1934 Act which require the filing of "reports" or similar material. Other such provisions are found in Sections 12(b)(1), 13(a), 13(d), 13(f) and 15(d). Section 12(b)(1) requires every "issuer" of a security "registered on a national securities exchange" to file an "application which shall contain . . . [s]uch information" as the SEC may require. 15 U.S.C. § 78l(b)(1). Section 13(a) requires every "issuer" of a registered security to file "such information and documents" and "such annual . . . and . . . quarterly reports" as the SEC may prescribe. 15 U.S.C. § 78m(a). Section 13(d) requires any person becoming the beneficial owner of more than 5% of certain classes of equity securities to file "a statement containing such . . . information" as the SEC may prescribe. 15 U.S.C. § 78m(d). Section 13 (f) requires every "institutional investment manager" to file "reports" as the SEC may prescribe. 15 U.S.C. § 78m(f). Section 15(d) requires certain issuers to file "supplementary and periodic information, documents and reports" as may be required by Section 13. 15 U.S.C. § 78o(d).

reliance upon such statement, shall have *purchased or sold* a security at a price which was affected by such statement" (emphasis added). 15 U.S.C. § 78r(a). As the Court of Appeals majority and dissent agree (11a-12a, 21a-23a), as other courts have recognized, and as the legislative history demonstrates, it is inescapable that the remedy provided by Section 18(a), which uses the very same word, "report", as does Section 17(a), is applicable to misstatements in Section 17(a) reports.

2. THE TRUSTEE AND SIPC CAN ASSERT NO CLAIM FOR RELIEF UNDER SECTION 18(a).—Both the Court of Appeals and the District Court recognize (11a, 49a), and the Trustee and SIPC concede, that neither they nor Weis' customers can meet the purchaser-seller requirement of Section 18(a), and that they thus cannot assert any claim for the express Section 18(a) remedy. Consequently, in order to find some purported basis in the 1934 Act to "federalize" their essentially common law claims for accountants' negligence and malpractice, they assert alleged implied rights of action under Section 17(a) itself.

3. THE STATUTORY SCHEME WHEREBY SECTION 18(a) PROVIDES AN EXPRESS AND LIMITED DAMAGE REMEDY FOR MISSTATEMENTS IN SECTION 17(a) REPORTS REFLECTS A CONGRESSIONAL INTENTION THAT SUCH REMEDY BE EXCLUSIVE AND THAT NO ADDITIONAL REMEDY BE IMPLIED FROM SECTION 17(a) ITSELF.—The express, and carefully limited, damage remedy provided by Section 18(a) for misstatements in Section 17(a) reports necessarily reflects a Congressional intention that a damage remedy for such misstatements would be available only as provided in Section 18(a)—*i.e.*, where a person purchased or sold a security in reliance thereon—and that no other damage remedy for such misstatements (*e.g.*, a damage remedy for brokerage firm customers who neither purchased nor sold securities in reliance

thereon) was intended or could be implied. As Judge Mulligan's dissent observes, "[the District Court] correctly found and, indeed, *common sense would dictate,* that section 18(a) expressly provides *the sole private remedy which Congress intended* to be available for a violation of section 17(a) and the other reporting sections of the [19]34 Act" (emphasis added) (22a).

4. THIS COURT'S DECISIONS IN AMTRAK, BARBOUR AND BLUE CHIP STAMPS COMPEL THE CONCLUSION THAT SECTION 18(a) PROVIDES THE EXCLUSIVE DAMAGE REMEDY FOR VIOLATIONS OF SECTION 17(a).—As Judge Mulligan's dissent correctly observes (24a-25a), the conclusion that Congress intended Section 18(a) to be the exclusive damage remedy for Section 17(a) violations accords with—indeed, is required by—decisions of this Court explicitly directing that, where a remedy is sought to be implied from a statutory provision for which a limited express remedy already is provided, the doctrine *expressio unius est exclusio alterius* is to be applied. For example, this Court's decision in *Amtrak, supra,* unequivocally directs that

> "[W]hen legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.' . . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.* Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created . . . are the exclusive means to enforce the duties and obligations imposed by the Act". 414 U.S. at 458.

See also *Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 419 (reiterating the "observation [in *Amtrak*] that express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature").

While this Court did state in *Amtrak* that the *expressio unius* doctrine must "yield to clear contrary evidence of legislative intent", 414 U.S. at 458, even the Court of Appeals majority here concedes that nothing in the language or legislative history of the 1934 Act indicates any Congressional intent to create a private right of action under Section 17(a) (9a). Consequently, *Amtrak* and *Barbour* require the conclusion that, in light of the existence of the express remedy in Section 18(a), Section 17(a) does not create any additional implied remedy. The contrary conclusion of the Court of Appeals majority thus conflicts with *Amtrak* and *Barbour.*

Moreover, to hold, as does the Court of Appeals majority, that Section 17(a) creates an implied right of action in addition to the express remedy of Section 18(a) also conflicts with the principles established by this Court in *Blue Chip Stamps* v. *Manor Drug Stores, supra.* There, in upholding the purchaser-seller requirement for claims under Section 10(b) of the 1934 Act and Rule 10b-5, this Court noted that "[t]he principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of § 10(b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities", and then, specifically addressing itself to Section 18(a) of the 1934 Act, stated that

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to

> 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . .' *It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action*" (emphasis added). 421 U.S. at 735-736.

Of course, as Judge Mulligan's dissent notes, the "anomalous" intention which *Blue Chip Stamps* said could not properly be imputed to Congress "is precisely what the majority is imputing to Congress in this case" by its holding that there is an implied right of action under Section 17(a) broader than (*i.e.*, in favor of brokerage firm customers who do not meet the purchaser-seller requirement of) the express remedy under Section 18(a) (26a).[8]

As aptly summed up by Judge Mulligan's dissent,

> "*Amtrak, Barbour* and *Blue Chip* compel the conclusion that the omission [of a remedy for Section 17(a) violations in favor of brokerage firm customers] was studied and that the implication of a damage action against accountants under this section is totally unwarranted. The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy

[8]This Court also observed in *Blue Chip Stamps* that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly", citing Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b). 421 U.S. at 734. This reinforces the conclusion that the limitation to purchasers and sellers of the express Section 18(a) remedy provided by Congress for Section 17(a) violations, and the failure by Congress to provide an express remedy for Section 17(a) violations in favor of brokerage firm customers who are not purchasers or sellers, demonstrate a Congressional intention and understanding that such brokerage firm customers are to have no right of action, either express or implied, for violations of Section 17(a) (see 25a-26a).

> provided was designed to exclude the class which is here seeking monetary relief." (26a-27a)

5. PIPER BARS IMPLICATION OF A PRIVATE DAMAGE REMEDY UNDER SECTION 17(a).—In *Piper* v. *Chris-Craft Industries, Inc., supra,* this Court emphasized that under the 1934 Act a private right of action is to be implied only where it is "necessary to effectuate Congress' goals". 430 U.S. at 26. *Accord, Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 477. As shown in Judge Mulligan's dissent, analysis of the scheme by which brokerage firms are regulated demonstrates that, in seeking to protect brokerage firm customers, "the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers[,] not to create private law suits for damages *after* insolvency has occurred", and therefore that "the importance to this scheme of implying a damage remedy *after* liquidation is dubious" (30a). To enforce compliance with the reporting requirements of Section 17(a), private damage actions thereunder in favor of persons not entitled to the remedy of Section 18(a) are not *necessary*; as the District Court here concluded, "criminal prosecutions and SEC injunctive actions seem abundantly sufficient" (53a) (see also p. 19 n.9, *infra*). As *Piper* explicitly makes clear, an "ever-present threat of damages" is not *necessary, because* "[t]he deterrent value, if any" of a private right of action is so speculative that it does not "provide significant additional protection". 430 U.S. 39-40.

B. The Court Of Appeals Majority Misapprehends The Statutory Scheme, And Fails To Apply The Analysis Required By, And Therefore Reaches A Result In Conflict With, This Court's Decisions

The Court of Appeals majority misapprehends the foregoing statutory scheme and fails to follow the controlling decisions of this Court. The following basic

errors are committed by the majority and, as Judge Mulligan's dissent demonstrates, leads the majority to a decision which conflicts with this Court's decisions.

1. THE COURT OF APPEALS MAJORITY ERRS IN FAILING TO APPLY THE ANALYSIS REQUIRED BY AMTRAK, BARBOUR AND BLUE CHIP STAMPS.—In holding that Section 17(a) creates an implied private right of action, the Court of Appeals majority plainly misapprehends the statutory scheme of the 1934 Act. Its basic error is its failure to apply the analysis required by *Amtrak*, *Barbour* and *Blue Chip Stamps* to this case, where there already exists an express remedy (Section 18(a)) for violations of the statutory provision (Section 17(a)) under which an implied remedy is sought. That analysis requires the Court of Appeals first to recognize the existence of the express remedy of Section 18(a), then to consider Sections 17(a) and 18(a) in light of the *expressio unius* doctrine, and finally to apply the doctrine to bar an implied remedy under Section 17(a) in the conceded absence of "clear contrary evidence of legislative intent". However, the majority instead purports first to analyze Section 17(a), and to determine whether it creates an implied remedy, *without any consideration of Section 18(a)* (6a-11a). Only after concluding that there is such an implied remedy does the majority finally give cursory consideration to Section 18(a), and then only to assert that it does not detract from the existence of such a remedy (11a-12a). Of course, as *Amtrak*, *Barbour* and *Blue Chip Stamps* make clear, that approach is based upon the patently erroneous view that Section 18(a) is in no way indicative of the Congressional intent as to whether Section 17(a) creates an implied remedy—a view which the majority acknowledges holding by its statement that "[w]e find no indication . . . *in the statute itself* . . . of any congressional intent either to create a private remedy under Section 17 or to deny one" (emphasis added) (9a).

2. THE COURT OF APPEALS MAJORITY ERRS IN FINDING SECTION 18(a) IRRELEVANT.—The Court of Appeals majority finds that Section 18(a) is irrelevant because brokerage firm customers are "members of a class peculiarly protected by Section 17" and "are favored wards of Section 17", that the express remedy of Section 18(a) will normally not be available to such customers, and therefore that "[w]e cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection" (11a).[9] However, the majority's conclusion simply does not follow from its premises. Even if it be assumed that Section 17(a) was specifically intended to protect brokerage customers, whereas Section 18(a) "wholly independent[ly]" was intended to provide rights only to purchasers and sellers (see 12a), the existence of Section 18(a) necessarily demonstrates a further Congressional intent that the purchasers and sellers referred to therein be the only class with a damage remedy for misstatements in Section

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[9]The Court of Appeals majority clearly overstates the issue when it says that customers will be "deprived . . . of the means of protection" without an implied right of action under Section 17(a). As Judge Mulligan's dissent spells out in detail, brokerage customers have many "protections", including the preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970), the deterrent effect of criminal and injunctive proceedings, and the availability of state law remedies. *Cf. Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970) ("That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. The remedy in many cases may be found in the state courts . . . . If there is to be a federal remedy, it is the Congress which must create it"), *cited with approval in Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 738-739 n.9. Thus, the real issue here is not whether to grant the customers a Section 17(a) implied remedy or else to leave them without any protection, but rather whether to add to the protections they already have the additional protection of a Section 17(a) implied remedy which Congress itself intentionally refused to provide.

17(a) reports. If, in enacting the 1934 Act, Congress was as aware of, and consciously concerned with protecting, both brokerage firm customers (its "favored wards" in Section 17(a), according to the majority) and purchasers and sellers (to whom it provided the express damage remedy in Section 18(a)), the withholding of an express damage remedy from the customers, while at the same time giving such a remedy to the purchasers and sellers, can only mean that Congress consciously intended that the customers not have a damage remedy and that their protection be provided in a different way. As Judge Mulligan's dissent correctly puts it,

> "if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers" (23a).

3. THE COURT OF APPEALS MAJORITY ERRS IN ITS APPLICATION OF THE PRINCIPLES OF CORT V. ASH.—As noted above (pp. 10-11, *supra*), the factors set forth in *Cort* v. *Ash*, *supra*, upon which the Court of Appeals majority relies to imply a private right of action under Section 17(a) (7a-11a), do not provide an appropriate analytical framework here because *Cort* itself limits its own relevance to "determining whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added). 422 U.S. at 78. However, even if the *Cort* factors are assumed to be relevant, the majority's analysis in terms of those factors is unacceptable because, among other things, it does not at any point

consider the significance of Section 18(a), which clearly bears on all four of the *Cort* factors.[10]

4. THE COURT OF APPEALS MAJORITY ERRS IN FAILING TO APPLY THE NECESSITY STANDARD OF PIPER.—The purported *Cort* analysis of the Court of Appeals majority also is fatally flawed by the majority's failure to apply the requirement articulated in *Piper* v. *Chris-Craft Industries, Inc.*, *supra*, that a private remedy is to be implied only where it is "*necessary* to effectuate Congress' goals" (emphasis added). 430 U.S. at 26. Application of that requirement bars implication of a private right of action under Section 17(a) (see p. 17, *supra*); and none of the reasons advanced by the Court of Appeals majority to support implication of such a right satisfies the requirement. For example, the majority's conclusion, purportedly premised upon *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), that "a private remedy is an essential supplement to the scheme of enforcement of section 17" because the SEC "does not have the resources to examine and audit all the documents that it receives"

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[10]First, Section 18(a) shows that insofar as substantive rights and remedies may be derived from reporting obligations imposed by the 1934 Act, only purchasers and sellers, and not customers, are *the class for whose special benefit such rights and remedies are provided.* Second, it shows *a Congressional intent* to limit a damage remedy to purchasers and sellers. Third, it shows that a Section 17(a) implied right would be *inconsistent with the legislative scheme* since it effectively would abolish the limitations placed on express civil remedies. Finally, it shows a Congressional understanding that any cause of action by customers for damages is *one traditionally relegated to state law*, which, under "well established tort law principles" discussed in Judge Mulligan's dissent (30a-32a), provides appropriate remedies—remedies which are being pursued as against Touche Ross not only by the Trustee and SIPC in the State Court Action, but also as noted hereinbelow (p. 33 n.19, *infra*), by Weis' customers themselves.

(10a-11a),[11] simply is unacceptable in light of this Court's recognition in *Piper* that "[e]ven though the SEC operates in this context under the same practical restraints recognized by the Court in *Borak*, institutional limitations alone do not lead to the conclusion that any party interested . . . should have a cause of action for damages". 430 U.S. at 41.[12] Similarly unacceptable is the majority's reliance upon an asserted need for nationally uniform standards for actions brought to recover losses after a brokerage firm has failed (11a). Since the *primary* legislative purpose in enacting Section 17(a) was to provide a system of reports and monitoring to *prevent* insolvency (see p. 17, *supra*), it is not *necessary* in order to achieve that purpose that such standards for recovery of losses resulting from liquidation be uniform. This Court recently has restated the principle that where state law remedies traditionally have been available federal courts should be reluctant to intrude federal remedies into the area to serve " 'at best a subsidiary purpose' of the federal legislation", *Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 478, and has recognized that relegation of plaintiffs to such state law remedies is appropriate, *e.g., Santa Fe Industries, Inc.* v. *Green, supra, id.* at 478 (state law appraisal remedy); *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 40-41 (common law tort remedy).

[11]As noted in the opinions of the Court of Appeals majority and the District Court, the SEC, pursuant to Section 17(a), has its own program of conducting audit examinations of the financial reports of brokerage firms (10a [n.12], 48a, 53a).

[12]As the District Court here stated, "the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any 'investors' and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act" (53a). Moreover, as Judge Mulligan's dissent points out, the problem faced by the SEC in *Borak* of examining proxy statements under demanding time limitations is not encountered with respect to its examination of Section 17(a) reports, and the SEC's burden also is lightened by examinations which are performed by the Exchange (32a [n.11]). As the dissent also notes, the rationale of *Borak* has been significantly restricted by more recent decisions of this Court (20a-21a).

II

The Holding By The Court Of Appeals Majority That, Despite The Express Remedy In Section 18(a), Section 17(a) Creates An Implied Private Right Of Action Conflicts With A Decision Of The Third Circuit, And Numerous District Court Decisions, Which Hold That No Rights Of Action May Be Implied Under Other Reporting Provisions Of The 1934 Act

The holding of the Court of Appeals majority that a private right of action may be implied under Section 17(a) conflicts in principle with the decision of the Third Circuit in *In re Penn Central Securities Litigation, supra,* as well as a substantial number of district court decisions, involving other reporting provisions of the 1934 Act. Those decisions all hold—for reasons equally applicable to the reporting provisions of Section 17(a)—that no private rights of action can be implied from the reporting provisions themselves, because Section 18(a) is the exclusive remedy for reporting violations, and because the creation of additional implied remedies from the reporting provisions themselves would ignore the Congressional intent and this Court's controlling decisions and distort the statutory scheme.

In re Penn Central Securities Litigation, supra, involved actions arising out of the operations of the Penn Central companies in which plaintiffs alleged that reports filed under Section 13(a) were misleading and asserted (because they were not purchasers or sellers of securities and thus did not fall within Section 18(a)) that they had an implied right of action for damages under Section 13(a) itself. The District Court dismissed the Section 13(a) claims, 347 F.Supp. 1327 (E.D.Pa. 1972), *decision as to Section 13(a) adhered to on reargument,* 357 F.Supp. 869 (E.D.Pa. 1973), emphasizing that

> "Section 13 is one of a number of provisions [of the 1934 Act] that require the filing of . . .

> reports. *See* §§. . . 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the [1934] Act", 347 F.Supp. at 1340,

and then, although recognizing that "Courts have implied civil remedies for violations of [certain] provisions of the [1934 Act]", held that Section 18(a) "is the exclusive remedy for violation of § 13(a)" because

> "when the legislature has specifically authorized or withheld the right to recover damages arising by reason of a violation of a statute, an implied right of action does not exist. . . . Where Congress has specifically authorized a remedy for violation of an act, the courts should not nullify the congressional scheme by implying a right of action on behalf of those not otherwise entitled to recover. . . . Given the express civil remedy for § 13(a) provided by § 18(a), we conclude that § 13(a) does not afford a private right of action", 347 F. Supp. at 1339-1340.

The Third Circuit affirmed. 494 F.2d 528 (3d Cir. 1974). It emphasized that a contrary holding "would result in the elimination of the purchaser-seller requirement for violations of § 13(a)", and that "the same considerations [which require application of the purchaser-seller requirement to section 10(b)] also apply to [require denial of] the contention . . . that we should imply a private right of action in section 13(a) to avoid the purchaser-seller requirement of section 18." *Id.* at 540-541.[13]

[13]Numerous district court decisions have reached the same result as did the Third Circuit in *In re Penn Central Securities Litigation.* See, *e.g., Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213 (S.D.N.Y. 1975), *aff'd by oral opinion*, 538 F.2d 312 (2d Cir. 1976) (Section 13(d)); *Cramer* v. *General Telephone & Electronics*, [1978] FED. SEC. L. REP. (CCH) ¶ 96,380 at pp. 93,326-93,327 (E.D. Pa. 1977) (Section 12(b)(1)); *DeWitt* v. *American Stock Transfer Co.*, 433 F.Supp. 994, 1004-1005 (S.D.N.Y.) (Sections 13(a) and 15(d)), *modified on other grounds*, 440 F.Supp. 1084 (S.D.N.Y. 1977); *Levy* v. *Johnson*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,899 at p. 91,324 (S.D.N.Y. 1977) (Section 13(a)); *Lewis* v. *Elam*, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,013 (S.D.N.Y. 1977) (Section 13(a)); *Meer* v. *United Brands Co.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,648 (S.D.N.Y. 1976) (Section 13(a)); *In re Equity Funding Corp. of America Securities Litigation*, 416 F.Supp. 161, 190 (C.D. Cal. 1976) (Section 13(a)); *McLaughlin* v. *Campbell*, 410 F.Supp. 1321, 1325 (D.Mass. 1976) (Section 13(a)); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D.Del. 1973) (Section 13(a)).

The reasoning and holding of *In re Penn Central Securities Litigation*, and of the other decisions reaching the same result, are clearly applicable to Section 17(a). Section 17(a), like the sections of the 1934 Act involved in those decisions, is a reporting provision, and Section 18(a) is as applicable to misleading reports filed under Section 17(a) as it is to such reports filed under those other sections.

Thus, the decision of the Court of Appeals majority creates a conflict between the Second Circuit and the Third Circuit concerning whether private rights of action may be implied under the reporting provisions of the 1934 Act, and this Court should grant certiorari to resolve that conflict.

III

The Holding Of The Court Of Appeals Majority That The Trustee And SIPC Are Appropriate Parties To Seek Recovery Of Customers' Damages Is Erroneous And Conflicts With Applicable Decisions Of This Court

Both the Court of Appeals majority and Judge Mulligan in dissent agree that, even if Section 17(a) creates an implied right of action for brokerage firm customers, neither the Trustee on behalf of Weis nor

SIPC in its own right is entitled to assert any right of action under Section 17(a), because neither is a member of any class protected thereby (12a [n. 13], 14a, 33a-34a). However, misapprehending the controlling decisions of this Court, the majority, again over Judge Mulligan's vigorous dissent, erroneously holds that the Trustee as "bailee" and SIPC as "subrogee" are appropriate parties to assert the Section 17(a) rights of certain *customers* of Weis (12a-13a).

A. The Holding With Respect To The Trustee Is Erroneous And Conflicts With This Court's Decision In *Caplin* v. *Marine Midland Grace Trust Co.*

Contending that Touche Ross' Section 17(a) violations caused the depletion of property held by Weis in trust for its customers, the Trustee seeks to assert the customers' damage claims, on the ground that Weis was the bailee of their property and thus had a sufficient interest therein to sue third parties for loss or injury thereto. However, any action by Weis itself (or by the Trustee as its representative) as bailee of customers' property would be an action to vindicate Weis' own possessory rights as bailee, and not the rights of the customers, *see generally* W. PROSSER, LAW OF TORTS 94-95 (4th ed. 1971); O. HOLMES, THE COMMON LAW 130-194 (1963 ed.), and even the Court of Appeals majority concedes that Weis itself, and the Trustee on behalf of Weis, have no right of action under Section 17(a) (14a). Nevertheless, the majority does find, in the Trustee's statutory duty to marshal and return customers' property, authorization for the Trustee to sue on behalf of customers whose property he is unable to return, to the extent that they have not been reimbursed by SIPC (13a-15a).

That holding of the Court of Appeals majority is erroneous because under Section 6(b)(1) of SIPA, 15

U.S.C. § 78fff(b)(1), the Trustee has the same title to property and powers as a bankruptcy or Chapter X trustee. *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), establishes the principle that such a trustee, and therefore the Trustee here, is not a proper party to assert claims of customers. In *Caplin*, this Court held that the Chapter X trustee of a corporation has no standing to assert claims on behalf of any particular class of creditors (there, holders of its debentures) against third parties, because

> "[i] nowhere in the statutory scheme is there any suggestion that the trustee . . . is to assume the responsibility of suing third parties on behalf of debenture holders . . . . [ii] [the corporation] could [not] make any claim . . . [and thus] any suit by debenture holders would not affect the interests of other parties to the reorganization . . . [iii] a suit by him on behalf of debenture holders may be inconsistent with any independent actions that they might bring themselves." 406 U.S. at 428-432.

Caplin compels the conclusion here that the Trustee may not sue on behalf of any particular class of creditors of Weis, including the class specified by the Court of Appeals majority, *viz.*, those Weis customers whose claims against Weis for their property have not been satisfied. In the first place, as in *Caplin*, there is no statutory authorization for any such suit. Second, any recovery by the Trustee would be on behalf of the customers only and would be of no benefit to other general creditors, since, as in *Caplin*, payment by Touche Ross of customers' claims simply would subrogate Touche Ross to the customers' claims against the Weis general estate. Third, there would be a proliferation of litigation since Weis' customers can sue—indeed, already have sued (see pp. 31, 33 n.19, *infra*)—Touche Ross; the

Trustee may be unable to bind the customers to any settlement; and the Trustee would be inappropriate as the customers' class representative, since he has no common interest with them and may have conflicting interests, in view of his obligations to general creditors and others.[14]

B. The Holding With Respect To SIPC Is Erroneous And Conflicts With This Court's Decisions In *Amtrak* And *Barbour*

SIPC is created by, and its powers are specified in, SIPA, which establishes a comprehensive statutory scheme for brokerage firm liquidations. Section 6(f)(1) of SIPA sets forth the subrogation rights of SIPC, as follows:

> "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be *subrogated to the claims of such customers with the rights and priorities provided in this section*" (emphasis added). 15 U.S.C. § 78fff(f)(1).

Both the Court of Appeals majority and Judge Mulligan in dissent hold that under Section 6(f)(1) SIPC, upon advancing funds to pay "claims" of customers, is subrogated *only* to the "claims" of such customers *against the Weis estate* (12a-13a, 34a).

In light of the comprehensive statutory scheme of SIPA, Congress clearly intended that SIPC's express statutory subrogation to customer "claims" against the

[14] In failing to recognize that such proliferation of litigation also is *unnecessary*, the Court of Appeals ignored the teaching of its own earlier decision in *Lank* v. *New York Stock Exchange*, 548 F.2d 61, 67 (2d Cir. 1977), which held it impermissible for a receiver of a brokerage firm to sue where the brokerage firm could not, even though any recovery would be for the benefit of public investors, because "those investors already have a cause of action in their own right . . . and the receiver's suit would add nothing to their rights."

brokerage firm's estate be SIPC's exclusive subrogation remedy, and that SIPC's subrogation rights not extend to the claims of customers against third parties. See, *e.g.*, *Amtrak, supra,* 414 U.S. at 458 ("when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies"); *Securities Investor Protection Corp.* v. *Barbour, supra; Rogers* v. *National Surety Co.*, 116 Neb. 170, 216 N.W. 182 (1927) (under statute establishing a "depositor's guaranty fund", express provision subrogating such fund to the rights of creditors paid by the fund to participate in the defunct bank's assets held, under *expressio unius* principle, to be the fund's exclusive subrogation remedy).

Nevertheless, the Court of Appeals majority, again over Judge Mulligan's vigorous dissent which emphasizes that SIPC is "a congressionally created corporation with limited powers to litigate" (34a), erroneously holds that SIPC has subrogation rights beyond those expressly provided to it in Section 6(f)(1), and is thereby subrogated also to the alleged Section 17(a) claims of the customers against Touche Ross. In so holding, the Court of Appeals majority is in conflict with this Court's decisions requiring application of the *expressio unius* doctrine and circumvents the intent of Congress as expressed in SIPA itself.

IV

The Questions Raised By This Petition Are Important To The Administration of the Federal Securities Laws And Should Be Decided By This Court

A. The Question of Whether Section 17(a) Creates Any Implied Right Of Action Should Be Decided By This Court

The holding of the Court of Appeals majority that Section 17(a) creates an implied private right of action for brokerage firm customers who are not purchasers or

sellers of securities as required by Section 18(a) should be reviewed by this Court. That holding is not only erroneous, and in conflict with this Court's controlling decisions in *Amtrak, Barbour, Blue Chip Stamps* and *Piper* and with the Third Circuit's decision in *In re Penn Central Securities Litigation,* but also raises questions which are important to the administration of the federal securities laws, for the following reasons.

1. The majority's recognition of a new implied right of action under Section 17(a)—a right of action not heretofore perceived by any other court or litigant in the 44 years since enactment of the 1934 Act—has the serious potential for greatly expanding the volume of litigation under the 1934 Act in, and thereby further burdening, the federal courts. All customers of failed or failing brokerage firms now have, under the majority holding, a potential Section 17(a) right of action against third parties allegedly responsible for misstatements in Section 17(a) reports. The resulting likelihood of proliferating litigation is seen from the facts that (i) between 1970 and 1977, 128 brokerage firms have failed and been placed in SIPA liquidation, (ii) such failures, seven of which occurred in the last year alone, continue to be a fact of life in today's mercurial and often troubled securities markets, and (iii) the total number of customers of such failed brokerage firms is huge, with more than 104,000 customer claims already having been satisfied in whole or in part in SIPA liquidations as of December 31, 1977.[15] That the prospect for a greatly-expanded volume of 1934 Act litigation is real, and not simply speculative, is demonstrated by the fact that on April 27, 1978, only six days after the decision of the Court of Appeals here, customers of Weis commenced in the United States District Court for the Southern District

[15]SIPC SEVENTH ANNUAL REPORT (1977) 5-6, 28.

of New York a class action against Touche Ross asserting implied rights of action under, and seeking damages for alleged violations of, Section 17(a). *Rosen* v. *Touche Ross & Co.* (S.D.N.Y. 78 Civ. 1943).[16] Moreover, the satisfaction of customer claims in brokerage firm liquidations does not remove—indeed, appears even to increase—the potential for 1934 Act litigation, in light of the majority's holding that SIPC, to the extent that it advances funds for payment of such claims, is subrogated to and may assert customers' Section 17(a) rights against third parties. As of December 31, 1977, SIPC had advanced almost $54,000,000 for payment of customers' claims (*i.e.*, almost $40,000,000 in excess of the $14,000,000 advanced for payment of such claims in the Weis liquidation)[17]—advances so substantial as to demonstrate a likelihood that SIPC will find itself compelled to assert such Section 17(a) claims.

Of course, the potential for greatly-increased 1934 Act litigation is not limited to situations where the brokerage firm involved is in liquidation. Under the holding of the Court of Appeals majority, Section 17(a) claims can be asserted by customers with respect to the Section 17(a) reports of any of the over 5,000 brokers and dealers registered with the SEC.

Finally, since Section 17(a) is a reporting provision, the majority's holding is authority for implying rights of action under all of the other reporting provisions of the 1934 Act in favor of persons who are not purchasers or

[16]Since *Rosen* v. *Touche Ross & Co.* was commenced after, and as the direct consequence of, the Court of Appeals decision, reference thereto necessarily does not appear in the record on which the decision was based. However, this Court may (and hereby is requested to) take judicial notice thereof. See, *e.g., Massachusetts* v. *Westcott,* 431 U.S. 322, 323 n.2 (1977).

[17]SIPC SEVENTH ANNUAL REPORT (1977) 6, 28-29.

sellers and who therefore may not assert the express remedy provided in Section 18(a). Numerous plaintiffs already have sought to assert such implied rights in the actions, including *In re Penn Central Securities Litigation*, already cited herein (pp. 23-25, *supra*); and, although the efforts of such plaintiffs heretofore have been unsuccessful, the majority's holding here only can give new impetus to such efforts.

2. The majority's holding, by eliminating the purchaser-seller requirement of Section 18(a), defeats the salutary purposes of that requirement which were recognized by this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 737-749, and which led it to uphold such a requirement as necessary to avoid the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs". 421 U.S. at 740, 743-749; see also *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 478-479.

3. This Court has noted that serious problems arise when a remedy which "would significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or express opinions with respect to matters under the [federal securities] Acts" is judicially implied, and has emphasized that "we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good". *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 214 n.33; *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 747-748. The substantial consequences to the accounting profession resulting from the majority's judicial creation of a remedy under Section 17(a) raise precisely those concerns of which this Court has expressed its awareness

and make this case an important one which merits this Court's review.[18]

4. There is also a serious question as to the need for the majority's holding. The claims asserted here, and the similar claims which might be asserted by any brokerage firm customer for misstatements in Section 17(a) reports, are essentially common law claims for accountants' negligence and malpractice, which traditionally have been a concern of state law and for which state law provides appropriate remedies.[19] The "federalizing" of such common law claims by means of Section 17(a), and the consequences which result therefrom, raise important questions which should be decided by this Court.

5. The majority's holding also raises important issues of statutory construction, including whether the Court of Appeals majority has usurped the legislative function by

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[18]This is particularly so since Section 17(a), which imposes reporting obligations on every "national securities exchange", every "broker or dealer" and every "registered securities association", does not even mention accountants. Rule 17a-5(b)(1) does call for reports of financial condition required of broker-dealers to be "certified by a certified public accountant or a public accountant who shall be in fact independent"; but there is a serious question as to whether any duty thereby is placed on accountants, and if it is, whether any duty not set forth in Section 17(a) can be derived from Rule 17a-5, because it is well-established that "the language of the statute must control the interpretation of the Rule". *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 472; see also *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 214 ("[The] scope [of the rule] cannot exceed the power granted the [SEC] by Congress").

[19]The *unnecessary* nature of the burden placed upon the federal courts by the Second Circuit's creation of a Section 17(a) implied right of action is further demonstrated by the fact that not only do the Trustee and SIPC have pending the State Court Action (see p. 4 and n.2), but customers of Weis also have pending New York state court actions against Touche Ross for damages allegedly resulting from Touche Ross' certification of the Weis financial reports, *Rosen* v. *Touche Ross & Co.* (Sup. Ct. N.Y. County, Index No. 21572/77) and *Rich* v. *Touche Ross & Co.* (Sup. Ct. N.Y. County, Index No. 23193/76).

substituting its own judgment for that of Congress with respect to what federal damage remedies are necessary and appropriate to effectuate the purposes of Section 17(a). *Cf. Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 65 ("Even were we to agree . . . that granting [plaintiff] a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place"), cited in the dissenting opinion below (33a).

6. This case also is significant because the Weis liquidation is the largest brokerage firm liquidation since the enactment of SIPA, SIPC SEVENTH ANNUAL REPORT (1977) 5-6; and, it is an important one for the litigants since it involves claims for aggregate damages of $65,000,000.[20]

B. The Question Of Whether The Trustee And SIPC May Assert Any Section 17(a) Rights Should Be Decided By This Court

The holding of the Court of Appeals majority that the Trustee and SIPC may assert, as "bailee" and

[20]In view of the importance of the questions raised by this Petition, the fact that the judgment sought to be reviewed is nonfinal (the Court of Appeals having reversed an order granting a Rule 12(b) motion to dismiss) should not impede the granting of certiorari. This Petition raises clear-cut issues of law which are fundamental to the further conduct of the case; reversal of the judgment would in fact terminate the action. This Court has granted certiorari in other cases which were at a similar procedural stage, where those cases raised similarly important issues affecting the administration of the federal securities laws. *E.g., Blue Chip Stamps* v. *Manor Drug Stores, supra; United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837 (1975); see *Daniel* v. *International Brotherhood of Teamsters,* 561 F.2d 1223 (7th Cir. 1977) (affirming district court's denial of Rule 12(b) motion), *cert. granted,* 98 S. Ct. 1232 (1978); cf. *Ernst & Ernst* v. *Hochfelder, supra* (the Court of Appeals had reversed an order granting summary judgment and had remanded the action for trial).

"subrogee", respectively, the Section 17(a) claims of certain Weis customers against Touche Ross also should be reviewed by this Court. That holding is erroneous, is in conflict with this Court's decisions in *Caplin* and *Amtrak,* and raises such important questions for the administration of the federal securities laws as the propriety of the assertion of customer claims against third parties by a SIPA trustee and by SIPC, and the appropriateness of permitting a SIPA trustee, SIPC and customers of a brokerage firm in liquidation all to assert simultaneously the same claims against a third party such as Touche Ross.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

August 23, 1978

Respectfully submitted,

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APPENDIX

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 136, 144—September Term, 1977.

(Argued November 14, 1977—Decided April 21, 1978.)

Docket Nos. 77-7183, 77-7186

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—v.—

TOUCHE ROSS & CO.,

Defendant-Appellee.

Before:

LUMBARD, MULLIGAN, and TIMBERS,

Circuit Judges.

Appeal from order of the Southern District of New York dismissing complaint. Inzer B. Wyatt, *J.*, ruled that neither SIPC nor broker's trustee in liquidation could maintain suit against accountant under section 17 of the Securities Exchange Act.

Reversed as to both plaintiffs and remanded.

JAMES B. KOBAK, JR., New York, N. Y. (Hughes Hubbard & Reed, John S. Allee, John W. Schwartz and Harold L. Kaplan, New York,

New York, on the brief), *for Plaintiff-Appellant Edward S. Redington, as Trustee for the liquidation of the business Weis Securities, Inc.*

CLARENCE FRIED, New York, N. Y. (Hawkins, Delafield & Wood, Philip R. Forlenza and Rafael Pastor, New York, N. Y., on the brief), *for Plaintiff-Appellant Securities Investor Protection Corporation.*

ARNOLD I. ROTH, New York, N. Y. (Rosenman Colin Freund Lewis & Cohen, Eugene Zemp DuBose, Jr. and Arthur S. Linker, New York, N. Y., on the brief), *for Defendant-Appellee.*

PAUL GONSON, Associate General Counsel; James H. Schropp, Assistant General Counsel; Theodore S. Bloch, Attorney, Securities and Exchange Commission, Washington, D. C., on the brief, *Amicus Curiae.*

LUMBARD, *Circuit Judge:*

In this appeal, rising out of the insolvency and liquidation of the brokerage firm of Weis Securities, Inc. ["Weis"], we are presented with the question whether a private cause of action exists under section 17 of the Securities Exchange Act of 1934[1] against account-

[1]15 U.S.C. § 78q (1976). This section was amended in 1975; in 1972, the date relevant to the instant case, it read, in relevant part:

(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

ants who prepare misleading statements of a broker's financial affairs, and if so, who may maintain such an action.

The district court dismissed the claims herein of the Securities Investor Protection Corp. ["SIPC"][2] and of Edward S. Redington, Weis' Trustee in Liquidation ["Trustee"], believing that no claim for relief was stated because no cause of action could be implied from section 17.[3] *Redington* v. *Touche Ross & Co.*, 428 F. Supp. 483 (S.D.N.Y. 1977). We conclude that customers of a broker have a right of action against an accountant whose audits of the brokerage firm are false or misleading. Because we believe that SIPC and the Trustee are appropriate parties to seek (between them) total recovery of the customers' damages, we reverse and remand.

I

Touche Ross & Co. ["Touche Ross"] served as Weis' independent certified public accounting firm from 1969 to 1973. In that capacity, Touche Ross prepared annual audits of Weis' affairs as required by section 17 and regulations thereunder.

The complaint herein alleged that during fiscal 1972, certain of Weis' officers conceived and executed a scheme to conceal from the regulatory authorities and

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[2]SIPC was created by the Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 91st Cong., 2d Sess., 84 Stat. 1636, *codified* at 15 U.S.C. §§ 78aaa-78*lll* (1976).

[3]Our decision in this case has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC. Judge Wyatt did not have the advantage of the SEC's position in this matter.

Judge Wyatt also dismissed, for lack of subject matter jurisdiction, five state common-law claims which the Trustee had sought to bring under principles of plenary bankruptcy or pendent jurisdiction, and four state common-law claims by SIPC, with respect to which diversity of citizenship had been alleged. Judge Wyatt ruled that SIPC was not a District of Columbia corporation for purposes of jurisdiction, and that complete diversity did not exist. Because of the view we take of the case, we need express no opinion as to the scope of bankruptcy jurisdiction in SIPA-receivership cases, nor as to the citizenship of SIPC.

the public Weis' dire financial condition.[4] The elements of this scheme appear in great detail in the complaint; for example, although Weis had suffered a loss for fiscal 1972 of greater than $1.5 million, its pre-tax earnings for that year were stated as being around $1.7 million.

When Weis' fiscal 1972 ended on May 26, 1972, Touche Ross proceeded to prepare and certify Weis' financial statements, and to answer the financial questionnaire required by the New York Stock Exchange of its member firms. In four opinion letters, dated July 7, July 7, July 21 and July 21 (all of 1972), Touche Ross represented that it had examined (i) the statement of Weis' current financial condition; (ii) Weis' answers to the financial questionnaire; (iii) Weis' consolidated balance sheet for the past year; and (iv) Weis' consolidated statement of earnings for the past five years, and found that each presented fairly and accurately the financial picture of Weis, in conformity with generally accepted accounting procedures.

In fact, Weis' financial condition was not as stated in the above four documents, but was far more precarious. As no steps were taken to attempt to remedy Weis' situation, it continued to deteriorate.[5] On May 24, 1973, the SEC sought an injunction preventing Weis and its officers from continuing to violate the '34 Act, and SIPC applied for a decree, pursuant to 15 U.S.C. § 78eee(a)(2), adjudging Weis' customers in need of protection under SIPA. Accordingly, Weis' liquidation was ordered by (then) District Judge Gurfein on May 30,

[4]In this posture of the case, we take—as we must—that view of the facts most favorable to plaintiffs, treating as true the allegations of the complaint. *See Escalera* v. *New York Housing Auth.*, 425 F.2d 853, 857 (2d Cir. 1970).

[5]Plaintiffs contend that the misleading statements certified by Touche Ross were the direct cause of the failure to take any remedial action, such as the infusion of capital or merger with another firm. Thus, they assert, Touche Ross' dereliction substantially contributed to Weis' forced liquidation and plaintiffs' losses. These contentions will be discussed more thoroughly in the body of the opinion.

1973, and Edward Redington was appointed Trustee for the liquidation.

SIPC and the Trustee jointly began an action against Touche Ross in New York state court on July 3, 1975. *Redington* v. *Touche Ross & Co.*, No. 13996/76 (Sup. Ct. N. Y. County). The common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the '34 Act were omitted. Five of the Trustee's six present "causes of action" appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims.

The instant suit was commenced on April 30, 1976. Under federal law and state common law, SIPC seeks to recover $14 million, either as subrogee of Weis' customers whose claims it has paid under SIPA, or as a member of the group directly injured by Touche Ross' delicts. Likewise under federal law and state common law, the Trustee is claiming $51 million; he contends that he may recover either by standing in the shoes of Weis' customers, since under SIPA, his is the responsibility to marshal and return their property,[6] or by standing in the shoes of Weis itself, since, he alleges, Weis—as an entity distinct from its conniving officers—was directly damaged by Touche Ross' unsatisfactory audit.

SIPC and the Trustee appeal from Judge Wyatt's order dismissing the complaint for failure to state a claim on which relief could be granted (with respect to the section 17 counts). Touche Ross asks us, in the event we reverse, to stay the federal action in favor of the state

[6]Property on hand when Weis was liquidated permitted the Trustee to return to customers 67% of the property they should have received. In addition, SIPC paid out some $14 million to customers and other creditors. Since under 15 U.S.C. § 78fff (1976), accounts are protected only up to $20,000 in cash and $50,000 in cash and securities, there may remain customers with uncompensated losses, who therefore retain claims against those who caused their losses. It is these claims that we hold the Trustee may assert. *See* part III B *infra*.

court suit.[7] This last issue, evidently, is one which Judge Wyatt has never had cause to consider.

II

The first question we address is whether customers of a brokerage firm are given any remedy by the '34 Act against accountants whose section 17 reports are false or misleading. There are two major considerations involved in this decision: the criteria laid down by the Supreme Court in *Cort* v. *Ash,* 422 U.S. 66 (1975), for finding an implied right of action in a statute which is silent on the issue; and the "purchase or sale" requirement reaffirmed by the Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975).

One preliminary matter must be dealt with. Judge Wyatt held that section 17 "was designed to supply administrative guidance in the bookkeeping area and not to create rights in anybody," and that it "does not impose any duty on accountants." 428 F. Supp. at 489, 491. We believe that, even if no right of action were implied, to see nothing but "administrative guidance" in a provision as crucial to the regulation of brokers as section 17 is to take far too narrow a view of the statute. Certified public accountants play a significant role in the scheme created by the '34 Act for the regulation of securities trading, as is recognized by the regulations promulgated by the SEC.[8] *See, e.g.,* 17 C.F.R. § 240.17a-5(b), (f), (g), (h), (i), (m). It is well established that section 10(b) of the '34 Act and rule 10b-5

[7]Plaintiffs aver that the state court action was commenced first only in a highly technical sense. It was begun by service of a summons without complaint (the complaint was not served until after the filing of the federal complaint), and then apparently ignored for some months by mutual consent. The parties agree that the state suit has progressed to the extent of responses by each plaintiff to one set of defendant's interrogatories.

[8]For a discussion of the functions and duties of accountants in this context, see *In re* Touche, Niven, Bailey & Smart, 37 S.E.C. 629, 5 Fed. Sec. L. Rep. (CCH ¶72,100, at 62,212 (1957); Note, *Accountants' Liability for False and Misleading Financial Statements,* 67 Colum. L. Rev. 1473 (1967).

thereunder impose a duty on accountants, for breach of which they may be sued. *See Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). We hold that section 17 of the '34 Act likewise imposes a duty on accountants.

A

The factors cited in *Cort* v. *Ash, supra,* 422 U.S. at 78, familiar through much repetition, which bear on the propriety of finding an implied right of action in a statute are:

> 1) Whether plaintiffs belong to the class for whose special benefit the statute was enacted;
>
> 2) Whether there is any indication of legislative intent on the issue;
>
> 3) Whether implication of a right of action is consistent with the policies behind the legislative scheme; and
>
> 4) Whether the cause of action in question is one traditionally relegated to state law.

A consideration of these four factors convinces us that implication of a right of action in favor of Weis' customers is appropriate.

1. The language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which Weis' customers are members of a class peculiarily protected by section 17.

The documents and reports that the SEC is empowered to require of brokers must be "necessary or appropriate in the public interest *or for the protection of investors*." 15 U.S.C. § 78q(a) (emphasis added). The

same is true of the examinations that the SEC is empowered to conduct. *Id.*[9]

In order to provide a complete and accurate picture of a broker's financial condition, the SEC requires that the broker enlist an independent accountant to audit and certify its statements, list any matters to which the accountant takes exception, and provide certain additional financial data. Rule 17a-5(b), (i) (k). Furthermore, a notice of any "material inadequacies" found by the accountant in the broker's procedures must be sent to the broker's customers. Rule 17a-5(m)(3).[10]

The function of this arsenal of financial reports is to protect the broker's customers. One of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325.

The net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its "principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers." Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967). As amended in order to take into account the creation of SIPC, the rule serves particularly to "protect customers prior to the time when the broker's . . . assets would be sufficient to satisfy customers in the event of liquidation."

[9]In 1957, when the SEC expanded certification requirements for section 17 reports,

> that step represented the Commission's considered view that certification and reporting requirements constituted a valuable regulatory tool for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.

SEC, *Study of Unsafe and Unsound Practices of Brokers and Dealers,* H. Doc. No. 92-231, 92d Cong., 1st Sess., at 24 (1971).

[10]Citations to rule 17a-5 are to 17 C.F.R. § 240.17a-5 as it existed in 1972. Rule 17a-5(j)-(o) were adopted on June 30, 1972, and appear in the *Federal Register* for July 21, 1972.

tion." Exchange Act Release No. 11,497, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,212.

It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows.

2. We find no indication, either in the statute itself or in its legislative history, of any congressional intent either to create a private remedy under section 17 or to deny one.[11]

The legislative history of the section is mute on the issue, leading to the conclusion that Congress never *explicitly* considered the question. Nor can it be said that Congress *implicitly* chose to deny a private right of action; section 17 is distinctly different in an important respect from statutes as to which such implicit intent has been found.

In *SIPC* v. *Barbour*, 421 U.S. 412 (1975), the Supreme Court noted that SIPA manifested a specific legislative intent to restrict enforcement to the SEC. *Id.* at 420, 425. In *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453, 458 (1974), a similar exclusivity was found to rest with the Attorney General; in *Cort* v. *Ash* itself, *supra,* 422 U.S. at 74-76, the Federal Election Commission was held to be the agency charged with exclusive enforcement.

We have recently indicated that an intent to commit enforcement of the securities statutes exclusively to the SEC will not readily be implied. *Abrahamson* v. *Fleschner,* 568 F.2d 862, 874 n.19 (2d Cir. 1977).

[11]To the extent that the court below relied on the remedy created by section 18 of the '34 Act as evidence of a legislative intent to deny a private remedy for violations of section 17, its concerns will be treated in part II B *infra.*

Nothing in section 17 induces us to treat it as an exception to this rule.

3. "Absent specific statements of legislative intent, we must examine the legislative purposes underlying the Act." *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 874, conclude that a private right of action under section 17 is consistent with those purposes.

A partial list of the many sections of the securities acts under which private remedies have been implied appears in *Franklin National Bank* v. *L. B. Meadows & Co.,* 318 F. Supp. 1339, 1341-42 (E.D.N.Y. 1970). *See* III L. Loss, Securities Regulation 1785 (2d ed. 1961). At least since *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) (section 14(a)), it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons; those persons may sue for the 'statutory tort' committed when the duty is breached.

We have held that section 17 imposes a duty on accountants in favor of brokers' customers. We note that—just as in *Borak*—the SEC was not meant to, and does not have the resources to examine and audit all the documents that it receives (in *Borak,* proxy statements; here, section 17 reports).[12] Both it and SIPC, as well as the broker's customers must rely on the certification by the accountants.

Neither SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost. Indeed, the cases cited by Judge Wyatt in support of the proposition that there exists injunctive and criminal relief for violations of section 17 do not involve

[12]In its *amicus* brief, the SEC advises us that, in fiscal 1976, over 5000 brokers and dealers were registered with it; that each of the approximately 750 broker-dealers that are not members of self-regulating organizations must be audited annually, as must the 500 or so against whom complaints are lodged; and that this leaves the SEC able to examine each year the statements of only 5% of broker-dealers who are apparently untroubled members of self-regulatory organizations.

accountants. *See* 428 F. Supp. at 490, and cases cited. Accordingly, we rule that a private remedy is an essential supplement to the scheme of enforcement of section 17.

4. Finally, it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting. Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' customers varies widely. There is no reason to believe that the remedy sought herein is one traditionally relegated to state law.

B

The court below found a particularly high barrier to plaintiffs in section 18 and the judicially created purchaser-seller doctrine. 428 F. Supp. at 489-90. Section 18 creates private remedy for "misleading statements" in "any application, report, or document filed pursuant to this chapter," in favor of "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . ." 15 U.S.C. § 78r.

Applying this language, and the holding of *Blue Chip Stamps, supra,* 421 U.S. at 736, Judge Wyatt ruled that the remedy provided by section 18 was exclusive, and that thus no remedy existed for brokers' customers injured as a result of an accountant's misleading statements, absent a purchase or sale of an affected security. We disagree.

Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.

Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced *not* to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se.

III

In light of the foregoing analysis, we decide that brokers' customers have a right of action against accountants for certifications that violate the standard set by section 17 and rule 17a-5. This does not, however, resolve the question whether the plaintiffs in the instant case, SIPC and the Trustee, are proper parties to bring the action.

A

SIPC asserts a right to bring this action both in its own right and as subrogee of the customers whose claims it has paid. We hold that SIPC may maintain the action as subrogee.[13]

SIPA provides expressly that SIPC, upon reimbursing a customer's losses, shall be subrogated to that customer's claims against the debtor's (here Weis')

[13]We need not reach the question whether SIPC could ever have a claim for damages other than on behalf of a broker's customers; we only note that as the creature of a 1970 statute, SIPC can hardly claim to have been a specially protected beneficiary of the '34 Act. SIPC makes much of 15 U.S.C. § 78bbb (1976), which treats SIPA as if it "constituted an amendment to, and was included as a section of" the '34 Act. Nonetheless, it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or in 1970; the cited portion of the 1970 statute appears to do no more than indicate that, except where specifically provided otherwise, any remedy created by SIPA is supplemental to the preexisting remedies of the '34 Act.

estate. 15 U.S.C. § 78fff(f)(1). Touche Ross contends that SIPC's statutory right of subrogation against the debtor's estate is its exclusive remedy, precluding any rights against third parties such as Touche Ross. We disagree.

Section 78fff is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section. However, there is no reason to believe that this was meant to destroy SIPC's general common-law right of equitable subrogation.

> [T]he general rule is that upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss.

31 N.Y. Jur., *Insurance* § 1620, at 510. *See Ackerman* v. *Motor Vehicle Accident Indemnification Corp.*, 18 App. Div. 2d 307, 239 N.Y.S.2d 463 (1st Dept. 1963) (explicit statutory provision did not destroy MVAIC's broader common-law right to subrogation).

Moreover, we believe that it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers. Accordingly, we find that SIPC is subrogated to the right of action implied in section 17 in favor of brokers' customers against third parties such as accountants. *See SEC* v. *Albert Maguire Securities Co.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,129, at 92,076 (3d Cir. July 27, 1977).

B

The Trustee contends that he is a proper plaintiff herein, both as the representative of Weis' estate and as bailee of Weis' customers' property. We hold that he may maintain this action on behalf of such customers as have not been fully reimbursed by SIPC.

The barriers to a right of action on Weis' behalf are insurmountable. It is apparent that brokers, such as Weis, were not included in the class of those *protected* by section 17; indeed, brokers are the very entities *regulated* by section 17.

Two recent cases in point are *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), and *Lank* v. *New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977). In each, a member of the class sought to be regulated by Congress attempted to claim the benefit of an implied right of action under the very statute that regulated it. *Chris-Craft* held that a defeated tender offeror could not enforce the Williams Act, 15 U.S.C. § 78o(e), against a successful tender offeror, because "a party whose . . . conduct was purposefully brought under federal control by the statute . . . can scarcely lay claim to the status of 'beneficiary' whom Congress considered in need of protection." 430 U.S. at 37.

In *Lank*, we decided, in a case not unlike the instant case, that the receiver of a liquidated brokerage firm could not—because the firm itself could not—sue a securities exchange for failure to force the firm to comply with the exchange's rules. We pointed out that the '34 Act did not afford protection "to the very members of the stock exchanges whose conduct was being regulated." 548 F.2d at 66. The extent to which *Lank* parallels the instant case precludes our holding that the Trustee may maintain this action on Weis' behalf.

However, none of the above considerations apply to an action brought by the Trustee as bailee of the property of Weis' customers. He is responsible for marshalling and returning their property; to the extent that he is unable to do so, he argues, he may sue on behalf of the customer/bailors any wrongdoer whom they could sue themselves.

Rule 17(a) of the Federal Rules of Civil Procedure reads, in part: "[A] . . . bailee . . . may sue in his own name without joining with him the party for whose

benefit the action is brought. . . ." The Advisory Committee Notes to this section, added in 1966,[14] point out by way of illustration that the "owner of a warehouse in which household furniture is stored is equally entitled to sue on behalf of the numerous owners of the furniture stored." 39 F.R.D. 69, 85 (1966). *See generally* 5 N.Y.Jur., *Bailments* §§ 118, 119.

To the extent that customers have claims that have not been satisfied either by Weis in liquidation, *see* note 6 *supra*, or by SIPC, they retain rights of action against Touche Ross. We hold that the Trustee, as bailee, is an appropriate real party in interest to maintain this action on their behalf.

IV

Since we hold that both SIPC and the Trustee may maintain this action against Touche Ross, we remand to the district court for further proceedings consistent with this opinion. We leave to it in the first instance a number of questions that will now arise: whether to stay the federal action pending determination of the state action;[15] whether to exercise pendent jurisdiction over the plaintiffs' common-law claims; and what the appropriate standard is for accountant liability in actions under section 17, *cf. Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976).

Reversed and remanded.

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[14]The purpose of the 1966 amendment was "[to] add to the illustrative list of real parties in interest a bailee—meaning, of course, a bailee suing on behalf of the bailor with respect to the property bailed." 39 F.R.D. 69, 84 (1966).

[15]In *Weiner* v. *Shearson, Hammill & Co.*, 521 F.2d 817 (9th Cir. 1975), the court of appeals chose to remand the question of a stay to the district court, despite its thorough discussion of the factors involved in the determination of the question.

TIMBERS, *Circuit Judge,* concurring:

I concur in all respects in Judge Lumbard's clear, concise and, in my view, correct majority opinion.

In view of the characteristically thoughtful and earnest dissent of our Brother Mulligan, however, I should like to add a few words, partly to supplement Judge Lumbard's opinion, but chiefly to suggest that Judge Mulligan's dissent be read in the light of the following observations.

First, in urging that customers of a broker-dealer in liquidation have no implied right of action for damages under Section 17 of the Exchange Act against accountants who prepare false or misleading reports required by that statute, the dissent understandably is disturbed by the *unanimous* opinion in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), as recently reaffirmed in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 37-45 (1977). Granted that the dissent's massive effort to distinguish or to apply a gloss to *Ash* is an artful attempt to circumvent this key decision, I fear that our dissenting colleague has misapprehended the essential purpose of *Ash* in stating certain factors to be taken into consideration in determining whether to imply a right of action under a given statute. The dissent at the outset, *post,* at , emphasizes that *Ash* is not relevant to a case which arises under a statute which expressly provides for a private right of action. This overlooks the fact that the Supreme Court specifically applied the *Ash* analysis in *Piper, supra,* 430 U.S. at 37-41, in determining whether a private remedy was implicit in Section 14(e) of the same statute with which we are here concerned, i.e. the Exchange Act. Assuming that what the dissent intends to emphasize, *post,* at , is that *Ash* does not apply when an *express remedy* is provided for the *specific wrong* complained of, it must be remembered that the Court reaffirmed the implication of a private right of action under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated

thereunder in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 730 (1975), despite the absence of legislative history on the subject, *id.* at 737, much less "clear contrary evidence of legislative intent." *Post,* at .

Second, the dissent's displeasure with *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), likewise is understandable. This seminal opinion written by the late Mr. Justice Tom Clark for a *unanimous* Supreme Court, in holding that Section 27 of the Exchange Act provided the jurisdictional underpinning for an implied private right of action for damages (as well as for declaratory and equitable relief) arising from violations of Section 14(a) of the Exchange Act, *id.* at 430-35, expressly recognized that "Private enforcement of [Commission rules] provides a necessary supplement to Commission action", *id.* at 432, and, that "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Id.* at 433. Despite our Brother Mulligan's herculean effort in dissent to buttress his assertion that *Borak* "has been significantly restricted by more recent decisions of the Supreme Court", *post,* at , those decisions strike me as expressly and emphatically reaffirming the *Borak* rule[1]—as Mr. Justice Stevens stated in *Piper, supra,* 430 U.S. at 67, "*Borak* remains a viable precedent."

Third, the dissent speaks disparagingly of the SEC amicus brief. *Post,* at 2725 n.1. As Judge Lumbard correctly points out, *ante,* at 2707 n.3, we were aided materially by the SEC brief, whereas the district court did not have the advantage of knowing of the SEC's position. Here again, our Brother Mulligan's attempt to disparage the SEC brief is understandable, for it urges forcefully and cogently that SIPC should be permitted to assert a private right of action under Section 17 of the

[1]For example, in *Piper, supra,* 430 U.S. at 25, Chief Justice Burger stated:

> "This Court has nonetheless held that in some circumstances a private cause of action can be implied with respect to the

Exchange Act under the circumstances of this case. But far more basic than whether the SEC as amicus supports or opposes one side or the other in litigation under the federal securities laws, *is that the position of the SEC should be known to the court.* That is the point of Judge Lumbard's observation referred to above. And it is especially important in a case of first impression such as the instant one involving a statute under which Congress has imposed on the Commission specific responsibilities.[2] Wholly aside from the instant case—where I find the

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1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies. *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) (§14(a)); *Superintendent of Ins.* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 13 n. 9 (1971) (¶10(b))."

In *SIPC* v. *Barbour,* 421 U.S. 412, 417 (1975), referring to *Borak,* Mr. Justice Marshall summarized its holding:

> "In light of the 'broad remedial purposes' of the Act and the SEC's representation that private enforcement was necessary to effectuate those purposes, the Court held that the action for damages could be maintained."

And in *Blue Chip Stamps, supra,* 421 U.S. at 730, after summarizing the 25 year development of the decisional law that there is an implied private right of action under Rule 10b-5, Mr. Justice Rehnquist, referred to *Borak* as follows:

> "Such a conclusion was, of course, entirely consistent with the Court's recognition in *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432 (1964), that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'"

These decisions do not strike me as significantly "restricting" *Borak;* rather, they seem quite clearly to reaffirm *Borak* as a "viable precedent", each case turning of course on the particular statute or rule under consideration.

[2]Section 7 of SIPA, 15 U.S.C. §78ggg (1976). See *SIPC* v. *Barbour, supra,* 421 U.S. at 417.

The SEC cogently summarizes in its brief filed in our Court its interest in the instant appeal as follows:

> "The Commission respectfully submits this brief as *amicus curiae* because this appeal raises significant issues which could materially affect its administration of the federal securities laws. We believe . . . that permitting a private right of action under Section 17 of the Securities Exchange Act will provide a necessary supplement to the Commission's efforts to enforce that section and the rules and regulations thereunder. In addition, financial statements submitted by broker-dealers

SEC amicus brief to measure up to the Commission's high standard of competence and fairness—I do hope that our Brother Mulligan's disparagement of the SEC amicus brief will not be construed as a judicial signal, even in dissent, that the Commission should retreat to its position of a generation ago which drew sharp criticism from our Court. *Compare Blau* v. *Mission Corp.,* 212 F.2d 77, 81 (2 Cir.), *cert. denied,* 347 U.S. 1016 (1954), and *Roberts* v. *Eaton,* 212 F.2d 82, 84 (2 Cir.), *cert. denied,* 348 U.S. 827 (1954), *with Studebaker* v. *Gittlin,* 360 F.2d 692, 695 (2 Cir. 1966), and *Greene* v. *Dietz,* 247 F.2d 689, 695-98 (2 Cir. 1957) (concurring and dissenting opinions; per curiam opinion on rehearing). *See Some Practical Aspects: The SEC and The Federal Judiciary,* 41 A.B.A.J. 1136, 1137-38 (1955).[3]

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pursuant to the Act play a key role in the Commission's administration and enforcement of various statutory provisions designed to protect against loss of the funds and securities of customers of broker-dealers and to maintain confidence in the securities markets at a high level. The availability of a right of action under Section 17 will thus have a direct bearing on the overall effectiveness of such statutory and regulatory provisions as those regarding hypothecation and segregation of securities and cash, and the net capital rule, designed to ensure the ability of brokers to meet their financial obligations as custodians of customer property. In addition, the Commission has 'plenary authority' with respect to the operations of the Securties Investor Protection Corporation, and is therefore concerned that SIPC have the ability to recover funds needlessly expended due to the wrongful acts of others, thus preserving the funds available to compensate losses suffered by the customers of brokers." (footnotes omitted). SEC Amicus Curiae Brief, filed August 31, 1977, at 3-4.

[3]I am pleased to note that, in response to my concurring opinion, Judge Mulligan very commendably has disclaimed any intention to disparage the SEC amicus brief below, n.1, last paragraph. This reflects the good judgment and fairness for which our distinguished colleague is well known. As a former Dean of the Fordham Law School, I think that Judge Mulligan would join in taking judicial notice of one of the leading expositions of the history and functions of the amicus curiae through centuries of development of the law. Beckwith and Sobernheim, Amicus Curiae—MINISTER OF JUSTICE. 17 Fordham Law Review 38 (1948).

Accordingly, after carefully considering Judge Mulligan's dissenting opinion, especially in the light of the observations set forth above, I concur without qualification in Judge Lumbard's majority opinion.

MULLIGAN, *Circuit Judge* (dissenting):

In my view this case was properly decided by Judge Wyatt and the order and judgment dismissing the complaint should be affirmed.[1] The majority announces that "[a]t least since *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) . . . it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons, those persons may sue for the 'statutory tort' committed when the duty is breached." Majority opinion at 2715. The *Borak* rule, which liberally implied private actions in federal regulatory acts on a statutory tort theory, has been significantly restricted by more recent decisions of the Supreme Court which are misapplied by the majority opinion.[2]

[1]The majority comments in footnote 3 that its decision has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC and that Judge Wyatt did not have the advantage of the SEC's position in this matter. The Supreme Court, however, in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1. 41 n.27 (1977) observed that ". . . its [the SEC's] 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants." That, of course, is the principal issue in this case as well. It should also be added that a substantial part of the SEC brief is devoted to the argument that SIPC in its own right may assert a private right of action for violations of section 17 of the '34 Act. This proposition was not only rejected below but was repudiated by the majority in its footnote 13.

I do not "disparage", as my Brother Timbers would have it, the brief of the SEC. I simply do not agree with it—neither does the majority, at least to the extent I have indicated. Nor do I dispute the propriety of its submission. I cannot believe that disagreement with the opinions of any agency can sensibly discourage the filing of a brief expressing its views as *amicus curiae (sed non parens curiae)*. It remains the function of the bench to construe the law as best it can even though that involves on occasion disagreement with one's colleagues or even an agency.

[2]These decisions discussed in the text, *infra*, include *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), *Cort* v. *Ash*, 422

While the majority purports to consider the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975), it must be emphasized that Justice Brennan in his opinion in *Cort* carefully restricted their application: "In determining whether a private remedy is implicit in a statute *not expressly providing one*, several factors are relevant." 422 U.S. at 78 (emphasis supplied). In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 37 (1977) Chief Justice Burger's opinion similarly confined the *Cort* factors, noting that they are " 'relevant' in determining whether a private remedy is implicit in a statute *not expressly providing one*." (Emphasis supplied).

In the instant case, however, we are confronted with a statute for which Congress has clearly provided a remedy in the event of certain violations. Admittedly, section 17(a), set forth in footnote 1 of the majority opinion, does not itself include any private remedy for an infraction of its terms. It simply requires that brokers or dealers such as Weis, make, keep and preserve records and make such reports as the SEC may prescribe by its rules and regulations in the interest of the public and for the protection of investors. Other comparable sections of the '34 Act (the Act) also provide for the filing of reports. See sections 13(a), 15 U.S.C.§ 78m(a); 13(d), 15 U.S.C.§ 78m(d); 13(f), 15 U.S.C. § 78m(f); and 15

U.S. 66 (1975); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) *(Amtrak)*; see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). Numerous commentators have acknowledged the substantial retreat from *Borak* represented by these subsequent Supreme Court rulings. E.g., Climan, Civil Liability Under the Credit-Regulation Provisions of the Securities Exchange Act of 1934, 63 Cornell L. Rev. 206, 261-69 (1978); Comment, Implying Private Causes of Action From Federal Statutes: *Amtrak* and *Cort* Apply the Brakes, 17 B.C. Ind. & Com. L. Rev. 53, 64 (1975); Comment, Private Rights of Action Under *Amtrak* and *Ash:* Some Implications for Implication, 123 U. Pa. L. Rev. 1392, 1416 (1975); Note, Implication of Private Actions from Federal Statutes: From *Borak* to *Ash*, 1 J. Corp. Law 371 (1976); 30 Vand. L. Rev. 905, 908-10 (1977).

(a), 15 U.S.C. § 78o(d). Like section 17(a), these sections include in their text no provisions for a private remedy.

Section 17 is immediately followed, however, by section 18(a), 15 U.S.C. § 78r(a), entitled "Liability for Misleading Statements" which does provide an express private remedy for violation of the reporting provisions of the Act. It states:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the '34 Act] or any rule or regulation thereunder . . . , which statement was . . . false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have *purchased or sold a security* at a price which was affected by such statement, for damages caused by such reliance unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading.

(Emphasis supplied).

Section 18(a) follows upon the heels of section 17. Its subject matter covers reports or documents filed pursuant to the '34 Act and regulations promulgated thereunder. Thus, Judge Wyatt correctly found and, indeed, common sense would dictate, that section 18(a) expressly provides the sole private remedy which Congress intended to be available for a violation of section 17(a) and the other reporting sections of the '34 Act. Furthermore, most courts which have considered the issue have found section 18(a) to contain the only remedy for violation of the Act's reporting sections.[3]

[3] *Meer* v. *United Brands Co.*,[1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶95,648 at p. 90,213 (S.D.N.Y. 1976); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1340 (E.D. Pa. 1972), relevant point adhered to on reargument, 357 F.Supp. 869 (E.D. Pa. 1973), aff'd, 494 F.2d 528, 539-40 (3d Cir. 1974); see *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213, 214 (S.D.N.Y. 1975), aff'd without opinion, 538 F.2d 312 (2d Cir. 1976). But see the district court cases discussed in *In re Penn Central Securities Litigation, supra*, 494 F.2d at 540 n.18.

It should be noted that in a case related to that at bar the customers of Weis brought a class action against Touche Ross alleging, *inter alia*, that Touche Ross' certification of the same financial statements involved here was in violation of Rule 17a-5, 17 C.F.R. § 240.17a-5 and gave the customers a cause of action under section 18(a). *Rich* v. *Touche Ross & Co.*, 415 F.Supp. 95, 101-02 (S.D.N.Y. 1976). Judge Brieant dismissed the complaint, finding that since the plaintiffs did not meet the purchaser-seller requirements of 18(a) they stated no claim for the alleged violation of Rule 17a-5. Id. at 102-04.

It seems clear, then, that the statutory scheme enacted by Congress provides in section 18(a) an express but limited remedy for violations of section 17(a). As noted above, the Supreme Court has repeatedly limited use of the *Cort* factors to instances in which *no* statutory remedy whatsoever has been provided. Hence, it must seriously be questioned whether the *Cort* factors are even the appropriate analytical tool to determine whether an implied private right of action should exist for infractions of section 17(a). Nonetheless, using a *Cort* analysis the majority finds an implied private damage remedy because it determines that brokers' customers are "favored wards" of, and a class "peculiarly protected" by section 17. Therefore, states the majority, we cannot assume that the Congress intended to deprive them of "the means of protection." Majority opinion at 2716.

I believe the majority reasoning is faulty in two major respects. In the first place, if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers.

The principle of statutory construction by which one reaches this result is somewhat forbiddingly known as *"expressio unius est exclusio alterius"*. This maxim was recently emphasized and applied by the Supreme Court in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) (*Amtrak*). There the Court held that the plaintiff association of railroad passengers had no implied cause of action as primary beneficiaries of the Rail Passenger Service Act of 1970 since that Act expressly provided for enforcement by the Justice Department. In its opinion, the Court observed:

> A frequently stated principle of statutory construction is that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." . . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.* Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created are the exclusive means to enforce the duties and obligations imposed by the Act.

414 U.S. at 458.

Soon after its decision in *Amtrak* the Supreme Court reaffirmed its reliance on the *expressio unius* principle in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412, 418-19 (1975). In finding that the express statutory grant to the SEC of a right to seek injunctive relief to enforce duties under the Securities Investor Protection Act precluded an implied right in others to seek similar relief, the Court reiterated its observation in *Amtrak* that "express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature." Id. at 419.

Similarly, in the instant case the provision by Congress in section 18(a) of a narrow private cause of action for section 17(a) infractions militates strongly against our attributing to Congress a willingness to allow more expensive enforcement of the duties and obligations created by that section. Moreover, while the Court in *Amtrak* acknowledged that the *expressio unius* principle must "yield to clear contrary evidence of legislative intent," 414 U.S. at 458, the majority here concedes that it finds nothing in the language or legislative history of section 17(a) to indicate that Congress intended to create a private cause of action under that section. In my view appellants have failed to demonstrate the "clear contrary evidence" to rebut the conclusion that the limited express right of action under section 18(a) is the exclusive remedy for a breach of section 17(a).[4]

We find further support for the position that there is no private right of action implied under section 17(a) in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). There the Court commented: "When Congress wished to provide a remedy [under the '34 Act] to those who neither purchase nor sell securities, it had little

[4] I do not overlook Judge Timbers' recent opinion in *Abrahamson* v. *Fleschner,* 568 F.2d 862 (2d Cir. 1977), petition for cert. filed, 46 U.S.L.W. 3588 (U.S. March 21, 1978) (No. 77-1279), which the majority cites to distinguish *Amtrak* and *Barbour* on the ground that those cases do not involve implication of private actions under the securities acts. It is important to note that in *Abrahamson,* where the court found a private right of action for damages implied for violations of section 206 of the Investment Advisers Act, 15 U.S.C. § 80b-6, Judge Timbers, in his opinion for the majority, repeatedly stressed that the Investment Advisers Act made *absolutely no provision* for express private actions. Id. at 872, 874, 875. The opinion in *Abrahamson* contrasts this omission to those other securities acts which contain "sections *expressly* granting injured parties a private action for damages." Id. at 874 (emphasis in original); see *Piper* v. *Chris-Craft Industries, Inc., supra,* at 24-25. Indeed, in this connection the opinion then refers specifically to section 18 of the '34 Act. Id. at 874 n.20. Judge Timbers concluded: "Had Congress provided explicitly for private damage actions it would be unnecessary to consider whether the remedy should be judicially implied." Id. at 875. This conclusion in *Abrahamson* is in fact strongly supportive of the analysis in this dissent.

trouble in doing so expressly" 421 U.S. at 734. Judge Wyatt's opinion below reviews several such sections of the '34 Act which impose liability on persons other than purchasers or sellers. 428 F.Supp. at 490. The presence of these provisions in the '34 Act reinforces the conclusion that the framing of the section 18(a) remedy in terms of purchasers and sellers of securities to the exclusion of customers of broker-dealers was an intentional congressional limitation on the class for whom a private action would be avilable in the event of a section 17(a) violation.

The Supreme Court in *Blue Chip* also addressed itself specifically to section 18:

> Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . . It would indeed be anomalous to impute to Congess an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.

421 U.S. at 736.

But that is precisely what the majority is imputing to Congress in this case. The misleading reports which create the basis for the claim here made were required to be filed by section 17(a) of the '34 Act and the remedy provided by section 18(a) concedely encompasses not broker-dealer customers but only securities purchasers or sellers.[5] I find that *Amtrak, Barbour* and *Blue Chip*

[5]It should be noted that in another suit arising out of the Weis debacle Judge Wyatt has sustained a section 18(a) claim asserted by a plaintiff bank which allegedly purchased securities of Weis in reliance on the section 17(a) reports involved in this case. *Exchange National Bank* v. *Touche Ross & Co.*, 75 Civ. 916 (S.D.N.Y.).

compel the conclusion that the omission was studied and that the implication of a damage action against accountants under this section is totally unwarranted. The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy provided was designed to exclude the class which is here seeking monetary relief. Thus, the majority's holding in my view goes beyond statutory construction; it amounts instead to judicial legislation.

II

The second flaw in the majority opinion is the failure to consider the impact of *Piper* v. *Chris-Craft Industries, Inc., supra,* in its discussion of the *Cort* factors. In *Piper* the Court, while again carefully limiting its holding to cases where the statute to be construed provides no private remedy, id. at 24-25, emphasized that private relief will be implied in favor of a particular class intended to be protected by the statute only when it is " 'necessary' " to effectuate Congress' goals. 430 U.S. at 25.[6] The inquiry called for is to ascertain the congressional purpose and to determine whether a private damage action by brokers' customers is a *necessary* adjunct, id., to accomplish the primary congressional goal embodied by the legislation. *Cort* v. *Ash, supra,* at 84.

The plain language of section 17 establishes the congressional concern that the SEC be kept on notice of the financial health and stability of registered broker-dealers through whom public investors purchase and sell securities.

[6]The underscoring of the element of necessity three times in the *Piper* opinion, 430 U.S. at 25, indicates the emphasis the Court wished to bring to this factor in determining whether a private remedy should be implied. *Piper,* therefore, is not simply a restatement or affirmation of *Cort* but adds a significant gloss. *Wilson* v. *First Houston Investment Corp.*, 556 F.2d 1235, 1239, 1240 (5th Cir. 1978).

The SEC itself has long recognized that the primary protection for brokers' customers lies in preventive monitoring: "customers do not open accounts with a broker relying on suit, judgment and execution to collect their claim—they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." *Guy D. Marianette,* 11 SEC 967, 971 (1942). Hence, the broker-dealer is required to file reports which are subject to such examination as the SEC may deem necessary or appropriate in the public interest or for the protection of investors. As the majority points out, a principal and, in fact, dominant method of investor protection is the net capital rule. Section 15(c)(3) of the '34 Act, 15 U.S.C. § 78o(c)(3), authorizes the SEC to provide safeguards with respect to the financial responsibility of broker-dealers including their "acceptance of custody and use of customers' securities, and the carrying and use of customers' deposits or credit balances." Pursuant to Rule 15c(3)(1)(b)(2), 17 C.F.R. § 240.15c3-1(b)(2), the SEC exempts broker-dealers who are members in good standing of the New York Stock Exchange (as was Weis) from compliance with SEC net capital requirments. This is because such broker-dealers are subjet to Exchange Rule 325, which is deemed by the Commission to impose requirements more comprehensive than the requirements of the SEC. Id. Under Rule 325 Weis was required to maintain a minimum prescribed ratio of aggregate indebtedness to net capital. Compliance by broker-dealers with the net capital rule is ensured by the filing of reports and monitoring by SEC as well as by the Exchange, which is authorized to enforce its regulations, see 15 U.S.C. § 78(f) and which, according to the SEC brief submitted on this appeal, makes annual examinations of each of its broker-dealer members to this end.

Congressional concern for the solvency of broker-dealers was not limited to the reporting and monitoring requirements of section 17. Following the boom of the

1960's a number of brokerage firms experienced financial instability and even failure. *Securities Investor Protection Corp.* v. *Barbour, supra,* at 415. The response of Congress was the enactment in 1970 of the Securities Investor Protection Act (SIPA), 15 U.S.C. §78aaa *et seq.* as an amendment to the '34 Act. Under SIPA Congress created the Securities Investor Protection Corporation (SIPC), the function of which extends well beyond providing protection to investors upon the liquidation of their brokers. As the Court noted in *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421:

> The SIPC properly treats an application for the appointment of a receiver and liquidation of a brokerage firm as a last resort. It maintains an early-warning system and monitors the affairs of any firm that it is given reason to believe may be in danger of failure.

The SEC too has noted that the primary purpose of the net capital requirements for broker-dealers is to give "the [SEC], self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time . . . of liquidation." 1934 Act Release No. 11497, June 26, 1975 [1975-76 Transfer Binder], CCH Fed. Sec. L. Rep. ¶80,212.

The majority here finds that since section 18(a) leaves broker-dealer customers without protection and since brokers' customers are the "favored wards" of section 17, it cannot agree that Congress simultaneously sought to protect them and to deprive the class of the means of protection. However, a review of section 17(a) and the rules promulgated by the SEC as well as the creation of SIPC, demonstrates that the means Congress employed to ensure solvency of broker-dealers were to require the keeping and filing of records, the maintenance of certain net capital balances and the oversight of

the SEC, SIPC and the Exchanges. Thus, the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers; not to create private law suits for damages *after* insolvency has occurred.[7]

Since the filing requirements of section 17(a) are designed to give early warning, the importance to this scheme of implying a damage remedy *after* liquidation is dubious. Congress made no suggestion either in 1934 or in 1970, when it enacted SIPA, that a private damage action was a *necessary* corollary of the section 17(a) reporting provisions. The threat of liquidation under SIPA as well as the criminal sanctions available for violations of section 17(a) certainly present a greater deterrent than private damage actions.[8] As the Supreme Court noted in *Piper,* "Nor can we agree that an ever-present threat of damages [beyond available injunctive relief] . . . will provide significant additional protection. . . . The deterrent value, if any, of such awards can never be ascertained with precision." 430 U.S. at 39-40.

Even more importantly, to the extent that a threat of private damage actions might further induce compliance with the reporting scheme of section 17 the majority has discounted the effect of available state law remedies, which arise not from state securities law protection of brokers' customers, but from well established tort law

[7]In fact SIPC's preventive measures have been quite successful. The vast majority of firms brought to SIPC's attention have been deterred from the necessity of undergoing a SIPC liquidation through a variety of tactics including mergers and withdrawal from the business of carrying customer accounts. See *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421 n.4.

[8]For example, in the instant situation the SEC initiated an action for injunctive relief against Weis and its officers. *SEC* v. *Weis Securities, Inc.,* 73 Civ. 2332 (S.D.N.Y.). A number of Weis' principals were also convicted of a criminal conspiracy to falsify Weis' books of account. See *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.

principles.[9] See, e.g., Restatement 2d of Torts §§ 531,552 (1977). Common law actions for damages against accountants have long been recognized. See, e.g., Note, Accountants' Liabilities For False and Misleading Financial Statements, 67 Colum. L. Rev. 1437 (1967). Where, as in the instant case, fraud is arguably alleged, it is important to note that should the actionable elements of fraud be provable, the states have universally permitted recovery to third parties who relied on the misrepresentations. Anno.: Liability of Public Accountant to Third Parties, 46 A.L.R. 3d 979, 982-83 (1972). While the state law treatment of actions based only on an accountant's negligence has not been so uniform, id. at 982, the trend in state law, based on generally recognized tort principles, has been to expand the accountant's liability for negligence to those clearly definable classes of third parties who the accountant knew would rely on the statements in question. See, e.g., *White* v. *Guarente,* 43 N.Y.2d 356, 401 N.Y.S.2d 474 (1977); Restatements 2d of Torts § 552 (1977). In fact, should scienter be held a required element of the action found implied by the majority in section 17,[10] see *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), it may well be that a state law action would provide a broader basis for accountant liability than the federal action implied here under the '34 Act.

In any event, the very existence of these state law remedies supplies that threat of liability which the majority essentially is seeking in order to promote adherence to the requirements under section 17(a).

[9]The same cannot be said of the appellants herein. In addition to the state law class action against Touche Ross which has been filed by Weis' customers in the Supreme Court of New York County, see *Rich v. Touche Ross & Co., supra,* 415 F.Supp. at 104, the appellants have initiated a state law action based on the same common law claims set forth in their complaint in this federal action. *Redington* v. *Touche Ross & Co.,* No. 13996/76 (Sup. Ct. N.Y. Co.).

[10]The point was reached neither by the majority here nor by Judge Wyatt below.

Thus, the majority wrongly dismisses the significance of availiable state law remedies on the ground that the standard of liability for private damage actions in connection with 17(a) violations must be national in scope. Since, as demonstrated above, the *primary* congressional purpose underlying the section 17 reporting scheme is prophylactic, uniformity of standards for actions brought to recover losses *after* the brokerage firm has failed simply is not *necessary* to achieving the primary goals of that statute. See *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 477-78 (1977).

The SEC has also argued, and the majority has accepted the position, that private damage actions are a necessary supplement to commission action because the SEC does not have the resources to audit the financial statements submitted under section 17(a). Whatever force this argument might once have had, see *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432, is seriously undermined by the Court's observation in *Piper* that "institutional limitations alone do not lead to the conclusion that any party . . . should have a cause of action for damages." 430 U.S. at 41. The argument that a regulatory agency is confessedly unable properly to regulate broker-dealers as charged by Congress and detailed by its own regulations, and that therefore the federal courts should find a damage remedy implicit in an act which studiously avoided giving one to the class sought to be represented here, is simply unpersuasive.[11]

In sum, I conclude that since section 18(a) of the Act does provide a damage remedy for the filing of misleading statements in section 17(a) reports, and since this remedy excludes from its coverage the customers of

[11]The problem faced by the SEC in *Borak* of examining proxy statements under demanding time limitations (10 days or even 2 days, 17 C.F.R. §§ 240.14a-6(a), (b)), as pointed out by Judge Wyatt, 428 F. Supp. at 491, is not encountered here. Moreover, the SEC itself has stated that its burdens in this connection are lightened by the Exchange, which makes annual examinations of net capital statements by its members.

broker-dealers, the *Cort* factors employed by the majority afford an inappropriate analytical framework for this case. Instead, under the reasoning of *Amtrak* and *Barbour* it is apparent that by limiting actions under section 18(a) to purchasers and sellers of securities Congress expressed its intent to deny recovery for section 17(a) violations to a broader class of plaintiffs. Nor have the appellants here adduced the strong contrary evidence of legislative intent regarding section 17(a) which would lead me to reach the conclusion, embraced by the majority, that implication of such a remedy is consistent with the legislative scheme. Moreover, even if the *Cort* factors were the proper mode of analysis in this case, they must be applied in conjunction with the gloss of *Piper.* Yet there is no showing here that a private damage remedy against accountants is *necessary* to vindicate the primary congressional purpose embodied in section 17(a). As Judge Medina observed in *Lank* v. *New York Stock Exchange,* 548 F.2d 61, 65 (2d Cir. 1977) where we refused to imply a private remedy in favor of the SIPC receiver of an insolvent broker-dealer against the Exchange: "Even were we to agree . . . that granting him a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place."

III

Having found no implied cause of action arising under section 17(a) in favor of customers of broker-dealers, I could of course find no derivative rights in either SIPC or the trustee. However, I also contest the holding that appellants are proper parties to maintain the action found by the majority to be implied in section 17(a). The majority has properly held that neither the trustee nor SIPC in its own right can bring any action under section 17(a) of the '34 Act. Neither can claim to be an intended beneficiary of that act since both are the

creatures of SIPA, enacted in 1970. Nor is either appellant a public investor. *Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 64-66 is dispositive of this issue.

Yet while denying to SIPC the right to bring a section 17(a) action on its own behalf, the majority also transmutes that entity into a subrogee clothed with the power in that capacity to bring a private damage action under 17(a) (an action itself now implied by the majority for the first time in the forty-four years section 17 has been on the books). By what alchemy a congressionally created corporation with limited powers to litigate, see *Securities Investor Protection Corp.* v. *Barbour, supra,* can now sue in a federal court for an alleged violation of section 17(a) of the '34 Act, is not made clear. When Congress created SIPC, its express but limited rights of subrogation were spelled out in SIPA: "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section." 15 U.S.C. § 78fff(f)(1). As the majority recognizes, those claims to which SIPC is subrogated by statute are clearly against the debtor's estate only and no rights against the accountant flow therefrom. Since Congress has delineated the subrogation rights of SIPC, its failure to provide for subrogation against any third party would clearly dictate that none exist under the previously discussed principle: *expressio unius est exclusio alterius. Rogers* v. *National Surety Co.,* 116 Neb. 170, 216 N.W. 182 (1927). The effect of the majority's extension of SIPC's subrogation rights is to circumvent the intent of Congress by ignoring the directive of SIPA that SIPC be subrogated *"with the rights and priorities provided in this section."* 15 U.S.C. § 78fff(f)(1) (emphasis supplied).

Similarly, the Trustee, held by the majority to have no direct cause of action under section 17(a), is

nonetheless found to have such capacity in his role as a bailee. The majority finds that his responsibility to marshal and return property to the customers of the debtor broker-dealer authorizes him to bring this action. But that responsibility of the Trustee is created by SIPA, 15 U.S.C. § 78fff(a)(1), and is inherent in his Trustee function, see also 15 U.S.C. § 78fff(b)(1). Having rejected his right to sue as a Trustee of Weis under *Lank* v. *New York Stock Exchange, supra,* I fail to see how denominating him a bailee adds a jot or a tittle to his statutorily created status as the representative of Weis—an entity regulated by, and precluded from suing under, the Act. Furthermore, the customers on whose behalf the Trustee seeks to maintain suit are not only entitled to bring, but have already initiated their own action against Touche Ross. See notes, 3, 9, *supra.* The SEC understandably has expressed no view on this point.

For these reasons I respectfully dissent and would affirm Judge Wyatt's decision below.

Judgment of the Court of Appeals

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the twenty-first day of April one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges,

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & CO.,
Defendant-Appellee.

77-7183

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

A. DANIEL FUSARO,
Clerk

By ARTHUR HELLER,
Deputy Clerk

Order Denying Petition For Rehearing

United States Court of Appeals

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

vs.

TOUCHE ROSS & Co.,
Defendant-Appellee.

Docket No. 77-7183

A petition for a rehearing having been filed herein by counsel for the appellee, Touche Ross & Co.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED

A. DANIEL FUSARO,
Clerk

Order Denying Rehearing En Banc

United States Court of Appeals

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & Co.,
Defendant-Appellee.

Docket No. 77-7183

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the appellee, Touche Ross & Co., and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED.

IRVING R. KAUFMAN
Irving R. Kaufman,
Chief Judge

[428 F. Supp. 483]

Opinion of the District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[March 1, 1977]

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs,

—against—

TOUCHE ROSS & Co.,
Defendant.

76 Civ. 1981

APPEARANCES:

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[428 F. Supp. 485]

WYATT, District Judge.

This is a motion by defendant Touche Ross & Co. (Touche) to dismiss the complaint pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, on two grounds: that the Court lacks subject matter jurisdiction, and that the complaint fails to state a claim upon which relief can be granted; in the alternative, it is sought to stay this

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action pending determination of an action between the same parties in the New York Supreme Court, New York County.

1.

Weis Securities, Inc. (Weis), was a large stock brokerage house. Weis was a broker-dealer registered with the Securities and Exchange Commission (SEC) and was a member of the New York Stock Exchange and of other stock exchanges. Weis is said to be a corporation, although where incorporated does not appear; its principal place of business is said to have been in the City of New York.

Touche is a firm of certified public accountants and acted as such for Weis.

In May 1973, Securities Investor Protection Corporation (SIPC) applied to this Court for a decree adjudicating, under the Securities Investor Protection Act of 1970 (15 U.S.C. §§ 78aaa and following; "SIPA"), that customers of Weis were in need of protection under SIPA, appointing a trustee for the liquidation of Weis, and affording other relief. This Court granted the application and appointed Edward S. Redington as Trustee (referred to usually as the "Trustee"). The proceedings in which the Trustee was appointed are described in *Exchange National Bank v. Wyatt,* 517 F.2d 453 (2d Cir. 1975). The Trustee was appointed on May 30, 1973; the "filing date" (15 U.S.C. § 78eee(b)(4)(B)) was May 24, 1973. Weis has since been in liquidation under SIPA.

2.

On July 3, 1975, the Trustee and SIPC commenced an action against Touche in New York Supreme Court, New York County (Index No. 13996/76; the action has a 1976 number because the first paper filed in the action was in 1976). The causes of action of each plaintiff were separately stated but there were in the complaint 21 paragraphs of "common allegations" which were then incorporated by reference in each claim of the Trustee and in each claim of SIPC. There were five causes of action by the Trustee and four causes of action by SIPC.

3.

The case at bar was commenced in this Court on April 30, 1976. The parties are the same as those in the State action. The Trustee and SIPC are again suing Touche.

The complaint in the case at bar asserts exactly the same claims as in the State action and adds claims by the Trustee and SIPC based on alleged violations by Touche

of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a and following; "the 1934 Act"), specifically of Section 17 of the 1934 Act (15 U.S.C. § 78q).

The "common allegations" are the same in both actions except that three paragraphs have been added here to shore up the added Section 17 claims of the Trustee and SIPC.

In this action, there are 6 claims by the Trustee and 8 claims by SIPC. (The claims are mistakenly called causes of action in the complaint, ignoring Fed.R.Civ.P. 8 and following the nomenclature in the State courts.)

The two plaintiffs have joined as such (presumably under Fed.R.Civ.P. 20(a) and properly) but their claims are several, not joint, and are stated in separate counts.

Counts two through six of the complaint in the case at bar are exactly the same as the five causes of action of the Trustee in the State action. Count one in the case at bar is the added claim under Section 17 of the 1934 Act.

The first four claims of SIPC in the case at bar are not in the State Action and are apparently intended to be based on Section 17 of the 1934 Act although in the first four counts there is no express reference to Section 17 (except as paragraphs 1, 16, 17, 21, and 22 of the complaint are incorporated by reference in these counts). The other four SIPC claims in the case at bar are exactly the same as the four SIPC causes of action in the State action.

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4.

The claims in the case at bar are alleged to arise under the 1934 Act and particularly under Section 17 thereof (15 U.S.C. § 78q), under Section 6 of SIPA (15 U.S.C. § 78fff), and under the common law (complaint, para 1).

The complaint avers that the Court has jurisdiction over the claims of the Trustee under Section 27 of the 1934 Act and under 28 U.S.C. § 1331. It further avers (in effect) that the Court has jurisdiction in bankruptcy by virtue of Section 6 of SIPA (15 U.S.C. § 78fff), under Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. §§ 11a(7), 502 and 515), and under 28 U.S.C. § 1334. The complaint also avers jurisdiction over the common law claims of the Trustee under principles of pendent jurisdiction (complaint, para 2).

Jurisdiction over SIPC's claims is alleged to exist under Section 27 of the 1934 Act and 28 U.S.C. § 1331, under the diversity of citizenship statute (28 U.S.C. § 1332) and under principles of pendent jurisdiction (complaint, para 3).

There then follows a series of "Common Allegations" comprising 24 paragraphs of the complaint which are incorporated by reference in both the six counts pleaded by the Trustee and the eight counts pleaded by SIPC.

The complaint avers that five of Weis' officers misstated the financial condition and results of operation of Weis in financial reports prepared at the end of fiscal year 1972, and that such reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act. It alleges that these reports were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders.

Plaintiffs aver that Touche breached duties it assumed toward them under Section 17 of the 1934 Act and under the common law when it became Weis' auditor and undertook to perform all necessary auditing and accounting services needed to audit the reports of financial condition that Weis was required to submit to the SEC. Essentially, these "common allegations" charge Touche with negligence and recklessness in the performance of its services (para 28); SIPC argues that they also

charge wilful misconduct (Memorandum of Plaintiff SIPC in Opposition to Defendant's Motion to Dismiss, p. 5). The complaint also alleges that Touche falsely certified that it had performed the necessary services and made false representations with respect to the Answers to Financial Questionnaire and other documents dated May 26, 1972. The "common allegations" then state that because of these failures and misrepresentations of Touche, the Exchange, the SEC and SIPC were prevented from knowing the true condition of Weis, and were prevented from acting to safeguard the assets of Weis and the property held by Weis for its customers; and that Weis continued to undertake financial obligations which it could not satisfy. As a result of the failure to act of the regulatory authorities, the liquidation of Weis became necessary when the facts were discovered. This was after the Weis assets and the property held by it for customers had been further depleted, and when it was too late to take remedial action. Upon liquidation, SIPC was required under SIPA to provide the Trustee with funds for the payment of claims submitted by customers and "certain other creditors" of Weis.

Paragraphs 32-49 of the complaint state six claims by the Trustee against Touche. The first claim charges that Touche violated, and aided and abetted the Weis officers in violating, Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, which require broker-dealers (such as Weis) to file accurate reports of their financial condition, including reports such as those certified by Touche. It further states (para 34) that "Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the ciass of persons which Section 17 of the 1934 Act was designed to protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934

Act",

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and that the injuries which occurred as a result of the liquidation of Weis were of the type that Section 17 was intended to prevent.

The Trustee's other five claims state that Touche breached duties to Weis under the common law of New York. The second claim charges Touche with negligence per se in violating Section 17 of the 1934 Act. The third charges Touche with negligence and malpractice. The fourth charges Touche with recklessness and gross negligence. The Trustee's fifth claim charges breach of contract. The sixth claim charges breach of express and implied warranties that Touche would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC.

In paragraphs 52-85 of the complaint, SIPC alleges eight claims against Touche, four on its own behalf and four on behalf of Weis' customers and certain other creditors. The first four claims allege violations of Section 17 of the 1934 Act and the others allege violations of the common law.

SIPC's first claim is under Section 17 of the 1934 Act and charges that Touche failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules promulgated thereunder in that opinion letters, answers to the financial questionnaire and financial statements prepared by Touche were false, inaccurate and incomplete, and that as a consequence the SIPC fund has been depleted in order to satisfy the claims of 34,000 customers and other creditors. Its third claim (also under Section 17) charges that Touche had knowledge, or, but for its errors and omissions, would have had knowledge, of the deceptions caused by the Weis officers in violation of the 1934 Act and that Touche aided and abetted the Weis officers in this

deception. The fifth claim (under common law) charges Touche with negligence and malpractice. The seventh claim (under common law) charges Touche with recklessness and gross negligence. SIPC's second, fourth, sixth and eighth claims are the same respectively as the first, third, fifth and seventh claims above described except that the second, fourth, sixth and eighth claims aver that Touche violated duties to the customers and certain other creditors of Weis and that SIPC is subrogated to the claims which such customers and other creditors could have asserted, this because SIPC has compensated them out of the SIPC fund.

5.

As seen above, the Trustee's first claim and the first, second, third, and fourth claims of SIPC are asserted under Section 17 of the 1934 Act (15 U.S.C. § 78q).

The argument for Touche is that there is no provision in Section 17 for a private right of action (as, for example, there is in Section 16) and that no private right of action is maintainable under Section 17.

The argument for plaintiffs is that, while no private right of action is expressly provided for in Section 17, a right of action should be implied for parties such as SIPC, the Trustee and customers and creditors of Weis who are said to fall within the "class for whose *especial* benefit the statute was enacted", citing *Cort* v. *Ash*, 422 U.S. 66, 78, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975; emphasis in original), which quoted from *Texas & P.R. Co.* v. *Rigsby*, 241 U.S. 33, 39, 36 S.Ct. 482, 60 L.Ed. 874 (1916).

6.

If there were any violations by Touche of Section 17, they occurred in 1972. Since then, there have been extensive amendments (in 1975) to Section 17 but in 1972 the relevant part of Section 17 read as follows:

> "Every national securities exchange, every member thereof, every broker or dealer who trans-

acts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 78o of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other

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records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

From the wording of this provision and in the context of the other provisions of the 1934 Act, it would appear that Section 17 was designed to supply administrative guidance in the bookkeeping area and not to create any rights in anybody. Section 17 has also been used as authority for the inspection program of the SEC, which is somewhat like the inspection work of the bank examiners.

In the 43 years during which the statute has been on the books, there has been no decision whether a private right of action can be asserted for a violation of Section 17. The Supreme Court, about a year ago, refused to consider whether there was such a private cause of action. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 194 fn. 13, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976).

There is nothing explicit to show any legislative intent respecting a private claim under Section 17.

The section, however, is entitled "Accounts and records, reports . . . ." and the very next section is entitled "Liability for misleading statements". This next section, Section 18 (15 U.S.C. § 78r), creates a private cause of action for "misleading statements" in "any application, report, or document filed pursuant to this chapter . . . " in favor of any person who purchased or sold a security at a price affected by the misleading statements. The subject matter of the two sections, their titles, and their juxtaposition would strongly suggest a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18. Plaintiffs here are obliged to argue that there is an implied private claim under Section 17 *broader* than the claim *expressly* created by Section 18. This is because they did not purchase nor sell any security "at a price affected . . . " etc., and thus cannot state a claim under Section 18. In this connection, it may be well to recall the words of the Supreme Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 736, 95 S.Ct. 1917, 1925, 44 L.Ed.2d 539 (1975):

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement . . . '. It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action."

Sections 13(a) and 13(d) of the 1934 Act (15 U.S.C. § 78m(a) and (d)) require the filing of specified reports by issuers and the filing of reports by those who acquire more than 5% of a registered equity security. Claims have been asserted under this Section by those who were not purchasers or sellers of any security and who thus could not state a claim under Section 18. They asked the Courts, as the plaintiffs do here, to imply a private right of action from the section alleged to have been violated. The Courts have declined to do so, holding that Section 18 is the only civil liability provision for a violation of the "reporting provisions" of the 1934 Act. *Meer* v. *United Brands Co.*, CCH Fed.Sec.L.Rep. ¶ 95,648 (S.D.N.Y. July 6, 1976; Carter, J.); *Myers* v. *American Leisure Time Enterprises*, 402 F.Supp. 213 (S.D.N.Y. 1975; Weinfeld, J.), affirmed without opinion 538 F.2d 312 (2d Cir. 1976); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1340 (E.D.Pa. 1972), affirmed 494 F.2d 528 (3d Cir. 1974).

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In *In re Penn Central Securities Litigation*, cited above, the District Court stated (347 F.Supp. at 1340):

> "Section 13 is one of a number of provisions that require the filing of applications, documents and reports. See §§ 12(b), 12(g), 15(b)(1), 15A(a), 16(a) and 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the Exchange Act, and we conclude that it is the exclusive remedy for violation of § 13(a)."

Opposed to the suggestion that the only protection intended for a violation of Section 17 was the liability created in Section 18, is the argument that customers of brokers and dealers in their dealings with such brokers

and dealers can never rely on the relief provided by Section 18 because in such dealings they can never meet the purchaser-seller requirement of that section. Section 17, runs the argument, was intended to protect those who choose to leave securities they have purchased, or cash resulting from securities they have sold, with their broker. Section 17's purpose is to protect these people by requiring their brokers to file reports with the SEC so that the SEC (and now SIPC as well) might police their activities so as to ensure the solvency of brokers.

Although Section 18 might not, of itself, foreclose the implication of a private right of action under Section 17, this does not mean that Section 18 is irrelevant to the question here.

It should be noted that when Congress wanted to create private causes of action for violations of provisions of the 1934 Act, it knew how to do it and did do it. In addition to the "reporting" violations made the subject of private rights of action in Section 18, Congress specifically provided for civil liability in Section 9(e) (15 U.S.C. § 78i(e)) and Section 16(b) (15 U.S.C. § 78p(b)) of the 1934 Act. Congress also provided for "liabilities of controlling persons" in Section 20 of the 1934 Act (15 U.S.C. § 78t).

Nor is it necessary to imply a civil liability under Section 17 in order to enforce its provisions. There can be a criminal prosecution. *United States* v. *Sloan*, 389 F.Supp. 526 (S.D.N.Y. 1975). The SEC can secure an injunction where a violation is proved of Section 17, described by Judge Tenney as "the bookkeeping rule". *SEC* v. *Resch-Cassin & Co., Inc.*, 362 F.Supp. 964, 979 (S.D.N.Y. 1973).

It remains to consider *J. I. Case Company* v. *Borak*, 377 U.S. 428, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) on which plaintiffs properly rely. In *Borak* a private right of action was implied for a violation of Section 14(a) of the

1934 Act (15 U.S.C. § 78n(a)) despite the lack of any provision therein for a private right of action and despite the existence of the civil liability provision in Section 18 (15 U.S.C. § 78r).

Borak was a suit by a stockholder of Case, the management of which solicited proxies for voting in favor of a merger of Case with another corporation. It was alleged that the proxy solicitation material was false and was in violation of Section 14(a) of the 1934 Act; that the merger would not have been approved by stockholders were it not for the false and misleading statements; and that the stockholders of Case had been damaged.

Section 14(a), together with an SEC Rule prescribed thereunder, makes it unlawful to solicit proxies by means of a proxy statement to stockholders containing false or misleading statements.

There is nothing in the statute which requires any filing with the SEC of proxy statements or other soliciting material. But the regulations of the SEC under Section 14(a) require that "preliminary copies" of the proxy statement or other soliciting material be filed with the SEC, as well as "definitive copies". 17 CFR § 240.14a-6

Soliciting material is plainly intended for the information of the stockholders, not of the SEC. The SEC has only an oversight or policing function.

In *Borak* a private right of action was implied because plaintiff, one of the stockholders solicited, was of the class intended to be protected by the statute; and because

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such private action was a "necessary supplement to Commission action" (377 U.S. at 432, 84 S.Ct. 1555) since the SEC had not the time for an "independent examination" of the soliciting material filed with it (377 U.S. at 432, 84 S.Ct. 1555).

But the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any "investors" and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act (Section 8(b); 15 U.S.C. § 78h(b)). Moreover, in examining the records and reports made under Section 17(a) the SEC does not have the time limitations applicable to the *Borak* proxy statements (ten days in some cases (17 CFR § 240.14a-6(a)) and two days in others (17 CFR § 240.14a-6(b)). The SEC has an inspection program, similar to that of bank examinations. It is not "necessary" to enforce Section 17 by private actions; criminal prosecutions and SEC injunctive actions seem abundantly sufficient. If, as is the case, the record keeping requirements of Section 17 are to give early warning to the SEC of financial difficulties of a broker and thus avoid liquidation, it cannot help to imply a private right of action *after* liquidation has become a fact.

The Supreme Court has refused to expand the *Borak* principle; indeed, the Court has restricted it.

In *Cort v. Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975), the Supreme Court refused to imply a private right of action for a violation of 18 U.S.C. § 610. The Court referred to *Borak* as an instance where there was "a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard" (422 U.S. at 82, 95 S.Ct. at 2090). There is no such "pervasive legislative scheme" in the case at bar.

And only last week, the Supreme Court, reversing our Court of Appeals, declined to imply a private right of action under Section 14(e) of the 1934 Act. *Piper* v. *Chris-Craft Industries, Inc.*, ____ U.S. ____, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977).

The test was whether "the creation by judicial interpretation of the implied cause of action . . . is *necessary* to effectuate Congress' goals" (emphasis supplied). This test has already been applied here and no such implication found "necessary".

The Supreme Court determined that plaintiff in *Chris-Craft* was not an intended beneficiary of the legislation. Here, neither the Trustee nor SIPC could possibly have been meant to be protected by Section 17, if for no other reason because the SIPA legislation was not passed until more than thirty years after Section 17. Additionally, neither the Trustee nor SIPC is an investor.

The case of *Lank* v. *The New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977), is instructive in this respect. There our Court of Appeals refused to imply a private right of action in the receiver of a member of the Exchange under Section 6 of the 1934 Act. The Court emphasized that brokers were not investors to be protected by the 1934 Act and that Section 6 was not enacted "for the purpose of affording protection to the very members of the stock exchanges whose conduct was being regulated . . . ". This analysis seems applicable to the plaintiffs in the case at bar.

Finally, Section 17 does not impose any duty on accountants. It specifically mentions a "national securities exchange", the members thereof, a "registered securities association", brokers, and dealers; it does not mention accountants. While the regulations do contain provisions respecting an accountant's certificate (17 CFR § 240.-17a-5(f)(g)(h)(i)), the oath is only by the broker or dealer (17 CFR § 240.17a-5(b)(2)). Judge Weinfeld discussed the problem in *Rothstein* v. *Seidman & Seidman*, 410 F.Supp. 244 (S.D.N.Y.1976) where he emphasized that a "special instruction" of the New York Stock Exchange laid a duty on its members but not on their accountants.

It is concluded that the Trustee's first claim and the first, second, third, and fourth claims of SIPC must be dismissed for failure to state a claim upon which relief can be granted.

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7.

The other five claims of the Trustee are common law claims. The question is whether this Court has any jurisdiction of them. It seems clear that this Court has no jurisdiction.

Pendent jurisdiction will not justify retention of these claims. The federal claim of the Trustee in count one has been dismissed before trial and we are instructed that, in such event, "the State claims should be dismissed as well". *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 726, 86 S. Ct. 1130, 16 L.Ed.2d 218 (1966)

The Trustee asserts an independent basis for jurisdiction under the general language of 11 U.S.C. § 11(a)(7).

The situation at bar, however, is controlled by 11 U.S.C. § 46 which provides that a trustee in bankruptcy may sue only in the courts where the bankrupt might have sued.

Section 6(c)(1) of SIPA (15 U.S.C. § 78fff(c)(1)) states in relevant part:

> "Except as inconsistent with the provisions of this chapter and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of Chapter X and such of the provisions . . . of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court

had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive . . .".

Section 502 of Title 11 states in relevant part:

> "The provisions of chapters 1 to 7, inclusive of this title shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 46 . . . shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters 1 to 7, inclusive." (emphasis in original)

Thus Section 46 of Title 11 is applicable to SIPA liquidations.

The arguments for the Trustee have been considered but cannot be accepted.

It may be mentioned that the Trustee urges a consent by Touche to the jurisdiction of this Court, a consent said to flow from the filing by Touche of a claim for professional services in the Weis liquidation. But the claim filed by Touche in the Weis liquidation was for accounting work in *European offices of Weis* in late 1972 and early 1973, as well as for a Stock Exchange audit as of April 27, 1973. The claim by the Trustee against Touche does not arise out of any work done for Weis by Touche and for which Touche filed a claim in the Weis liquidation. The claims are not "mutual" therefore but are unrelated and the consent of Touche cannot be found. *Cherno* v. *Engine Air Service, Inc.*, 330 F.2d 191 (2d Cir. 1964).

Under 11 U.S.C. § 46 we look to see whether Weis could have sued Touche in this Court. It seems undisputed that the principal place of business of Weis (28

U.S.C. § 1332(c)) was in New York and that members of the Touche firm are citizens of New York. Diversity jurisdiction would not exist of an action by Weis against Touche.

The second, third, fourth, fifth and sixth claims of the Trustee must be dismissed for lack of jurisdiction over the subject matter.

8.

The fifth, sixth, seventh, and eighth claims of SIPC are common law claims. As to these, SIPC argues for diversity jurisdiction on the ground that it should be considered for diversity purposes as a District of Columbia corporation. This argument cannot be accepted.

Under SIPA, SIPC was created as a corporation but it distinctly was *not* made a District of Columbia corporation. The relevant part of SIPA (15 U.S.C. § 78ccc(a)(3)) provides that SIPC is "subject

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to" the District of Columbia Nonprofit Corporation Act and has "all the powers" conferred on a nonprofit corporation by that Act. This does not mean, however, that it *is* a District of Columbia corporation. Note should be taken of the Act of Congress creating The American National Red Cross. Named persons are created "a body corporate and politic in the District of Columbia" (36 U.S.C. § 1a). For diversity purposes, the Red Cross is a citizen of the District of Columbia because the statutory language is specific, in marked contrast to that in SIPA. *Patterson* v. *Amer. Nat. Red Cross*, 101 F. Supp. 655 (S. D. Fla. 1951).

SIPC appears to be a federally created corporation which, like the American Legion (36 U.S.C. § 41), the

Disabled American Veterans (36 U.S.C. § 90a) and others, is not a citizen of any state for jurisdictional purposes. *Hancock Financial Corp.* v. *Federal Savings, etc.*, 492 F.2d 1325 (9th Cir. 1974); *Rice* v. *Disabled American Veterans*, 295 F. Supp. 131 (D. C. D. 1968).

There can be no jurisdiction simply because SIPC was created by Act of Congress because there is no stock ownership in SIPC by the United States. 28 U.S.C. § 1349.

Finally, the Trustee is a citizen of New York and is a plaintiff along with SIPC. Partners of Touche, the defendant, are citizens of New York. Thus, there is no complete diversity of citizenship within the rule of *Strawbridge* v. *Curtiss*, 3 Cranch 267, 2 L.Ed. 435 (1806).

The fifth, sixth, seventh, and eighth claims of SIPC must be dismissed for lack of jurisdiction over the subject matter.

Settle order and judgment on notice.

Dated: New York, New York
March 1, 1977

INZER B. WYATT
United States District Judge

STATUTES AND RULES

Securities Exchange Act of 1934

Section 17(a), 15 U.S.C. § 78q(a), as in effect prior to the Securities Acts Amendments of 1975, Pub. L. 94-29 (June 4, 1975):

"Accounts and Records, Reports, Examinations of Exchanges, Members, and Others

"SECTION 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

Section 18(a), 15 U.S.C. § 78r(a):

"Liability for Misleading Statements

"SECTION 18. (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration state-

ment as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisidiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant."

Securities Investor Protection Act of 1970

Section 6(b)(1), 15 U.S.C. § 78fff(b)(1):

"(1) Trustee powers.—A trustee appointed under section 5(b)(3) (hereinafter referred to as "trustee") shall be vested with the same powers and title with respect to the debtor and the property of the debtor, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under chapter X of the Bankruptcy Act have with respect to a bankrupt and a chapter X debtor. . . ."

Section 6(f)(1), 15 U.S.C. § 78fff(f)(1):

"(f) SIPC advances to trustee.—

(1) Advances for customers' claims.—In order to provide for prompt payment and satisfaction of the net equities of customers of debtor,

SIPC shall advance to the trustee such moneys as may be required to pay or otherwise satisfy claims in full of each customer, but not to exceed $50,000 for such customer; except that—

(A) insofar as all or any portion of the net equity of a customer is a claim for cash, as distinct from securities, the amount advanced by reason of such claim to cash shall not exceed $20,000;

(B) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(C) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any claims of any customer who is a general partner, officer, or director of the debtor, the beneficial owner of 5 per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights) or limited partner with a participation of 5 per centum or more in the net assets or net profits of the debtor; and

(D) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy claims of any customer who is a broker or dealer or bank other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank or otherwise, that claims of such broker or dealer or bank against the debtor arise out of transactions for customers of such broker or dealer or bank, in

which event, each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

"To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section."

SEC Rules

Rule 17a-5, 17 C.F.R. § 240.17a-5, as in effect prior to SEC revisions of 1975, 40 F.R. 59712-17 (Dec. 30, 1975):

"§ 240.17a-5 Reports to be made by certain exchange members, brokers and dealers.

"(a) *Filing reports.* (1) This rule shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer registered pursuant to section 15 of the act.

(2) Every member, broker or dealer subject to this rule shall file reports of financial condition containing the information required by Form X-17A-5, as follows: (i) A report shall be filed as of a date within each calendar year, except that *(a)* the first such report of a member, broker or dealer (other than one succeeding to and continuing the business of another member, broker or dealer) shall be as of a date not less than one nor more than five months after the date on which such member, broker or dealer becomes subject

to this rule (in the case of a registered broker or dealer this shall be the date the registration becomes effective) and *(b)* a member, broker or dealer succeeding to and continuing the business of another member, broker or dealer need not file a report as of a date in the calendar year in which the succession occurs if the predecessor member, broker or dealer has filed a Form X-17A-5 report in compliance with this rule as of a date in such calendar year; (ii) such reports shall be filed not more than 45 days after the date of the report of financial condition; and (iii) reports for any two consecutive years shall not be as of dates within four months of each other. The reports provided for in this rule shall be filed in duplicate original with the Regional Office of the Commission for the region in which the member, broker or dealer has his or its principal place of business.

(b) *Nature and form of reports.* Each report of financial condition filed pursuant to paragraph (a) of this section shall be prepared and filed in accordance with the following requirements:

(1) The report of a member, broker or dealer shall be certified by a certified public accountant or a public accountant who shall be in fact independent: *Provided, however,* That such report need not be certified if, since the date of the previous financial statement or report filed pursuant to § 240.15b1-2 or this section, (i) said member has not transacted a business in securities directly with or for other than members of a national securities exchange; has not carried any margin account, credit balance or security for any person other than a general partner; and has not been required to file a certified financial statement with any national securities exchange; or (ii) his

or its securities business has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or (iii) his or its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed of trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance, or security for any securities customer. A member, broker or dealer who files a report which is not certified shall include in the oath or affirmation required by paragraph (b) (2) of this section a statement of the facts and circumstances relied upon as a basis for exemption from the certification requirements.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, (i) the financial statement and supporting schedules are true and correct and (ii) neither the member, broker, or dealer, nor any partner, officer, or director, as the case may be has any proprietary interest in any account classified solely as that of a customer. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer

(3) If the schedules furnished pursuant to the requirements of items (a), (b), and (c) of part II

and the supplementary accountant's certificate furnished pursuant to the audit requirements of Form X-17A-5 are bound separately from the balance of the report, they shall be deemed confidential, except that they shall be available for official use by any official or employee of the United States or any State, by national securities exchanges and national securities associations of which the person filing such report is a member, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this paragraph shall be deemed to be in derogation of the rules of any national securities association or national securities exchange which give to customers of a member, broker or dealer the right, upon request to such member, broker, or dealer, to obtain information relative to his financial condition.

(c) *Use of certain statements filed with the Securities and Exchange Commission, State Commissions and National Securities Exchanges.* (1) Any member, broker, or dealer who is subject to the provisions of paragraph (a) of this section may file in lieu of the report required by that paragraph a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member, or with any agency of any State as a condition of doing business in securities therein, *Provided,* That (i) the copy so included reflects his financial condition as of a date not more than 45 days prior to the filing thereof with the Commission, and (ii) the report, as filed with this Commission, meets the requirements of this rule and Form X-17A-5 and contains the information called for by that form.

(2) At the request of any member, broker, or dealer who is (i) an investment company registered under the Investment Company Act of 1940, or (ii) a sponsor or depositor of such a registered investment company who effects transactions in securities only with, or on behalf of, such registered investment company, the Commission will accept any statement of his financial condition filed pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934 or section 30 of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder as a filing pursuant to this rule. Such a filing shall be deemed to satisfy the requirements of this rule for any calendar year in which such a financial statement is filed, *Provided,* That the statement so filed meets the requirements of the other rules under which it is filed with respect to time of filing and content.

(d) *Extension of time for filing reports.* In the event any member, broker, or dealer finds that he cannot file his report for any year within the time specified in paragraph (a) or (c) of this section without undue hardship, he may file with the Commission an application for an extension of time to a specified date which shall not be more than 90 days after the date as of which his financial condition is reported. The application shall state the reasons for the requested extension and shall contain an agreement to file the report on or before the specified date. The application shall be deemed granted unless the Commission, within ten days after receipt thereof, enters an order denying the application.

(e) *Exemptions.* Any "bank", as defined in section 3(a)(6) of the Act (48 Stat. 882; 15 U.S.C. 78c) shall be exempt from the provisions of this section.

(f) *Qualifications of accountants.* The Commission will not recognize any person as a

certified public accountant who is not a duly registered and in good standing as such under the laws of his place of residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(g) *Accountant's certificate*—(1) *Technical requirements.* The accountant's certificate shall be dated, shall be signed manually, and shall identify without detailed enumeration the items of the report covered by the certificate.

(2) *Representations as to audit.* The accountant's certificate (i) shall contain a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers, and including, if with respect to significant items in the report covered by the certificate any auditing procedures generally recognized as normal have been omitted, a specific designation of such procedures and of the reasons for their omission, (ii) shall state whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances; and (iii) shall state whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case.

(3) Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (h) of this section.

(h) *Accountant's certificate; options to be expressed.* The accountant's certificate shall state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein.

(i) *Accountant's certificate; exceptions.* Any matters to which the accountant takes exception shall be clearly identified; the exception thereto shall be specifically and clearly stated; and, to the extent practicable, the effect of each such exception on the related item of the report shall be given.

(j)(1) If a broker or dealer holding any membership interest in and subject to the capital rules of a national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b)(2) thereof ceases to be a member in good standing of such exchange, such broker or dealer shall, within two business days after such event, file with the Commission, as of the date of such event:

(i) A proof of money balances of all ledger accounts in the form of a trial balance;

(ii) A computation of aggregate indebtedness and net capital made in accordance with § 240.15c3-1;

(iii) An analysis of the aggregate market value of fully paid securities in customers' security accounts not segregated showing the location of such securities;

(iv) Ledger net credit balances of money borrowed from banks, trust companies, and other financial institutions and from others, which are fully or partially secured by securities carried for the account of any customer, showing, for each

loan, an analysis of the market value of all collateral for such borrowings by source of collateral, stating separately the market value of: (*a*) Securities carried for the accounts of customers, (*b*) securities owned by the broker or dealer or by any general or special partner or any director or officer of such broker or dealer, and (*c*) any other securities, and

(v) The aggregate amount of customers' ledger debit balances.

The report shall be filed at the Commission's principal office in Washington, D. C., and in duplicate original with the Regional Office of the Commission for the region in which the broker or dealer has his or its principal place of business; *Provided, however,* That such report need not be made or filed if the Commission, upon written request or upon its own motion exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement; *Provided further,* That the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

(2) Attached to the report required by subparagraph (1) of this paragraph shall be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the report is true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner, or if a corporation, by the chief executive officer,

or in his absence, by the person authorized to act in his place.

(3) For the purposes of this § 240.17a-5(j), "membership interest" shall include the following: Full membership, allied membership, associated membership, floor privileges, and any other interest that entitles a broker or dealer to the exercise of any privilege on an exchange.

(i) For the purposes of this section and § 240.15c3-1(b)(2), any broker or dealer shall be deemed to have ceased to be a member in good standing of such exchange when he or it has resigned, withdrawn, or been suspended or expelled from a membership interest in such exchange or has directly or through any associated person sold or entered into an agreement for the sale of a membership interest which would on consummation thereof result in the termination of the broker or dealer's membership interest in such exchange.

(4) Whenever any national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b) (2) thereof takes any action which causes any broker or dealer which is a member of such exchange to cease to be a member in good standing of such exchange or when such exchange learns of any action by such member or any other person which causes such broker or dealer to cease to be a member in good standing of such exchange, such exchange shall report such action promptly to the Commission, furnishing information as to the circumstances surrounding the event."

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

—against—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

SUPPLEMENT TO THE PETITION FOR A WRIT OF CERTIORARI

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Respondents.

SUPPLEMENT TO THE PETITION FOR A WRIT OF CERTIORARI

Petitioner Touche Ross submits this Supplement to its Petition for a Writ of Certiorari to point out the significance to this case of this Court's very recent grant of certiorari in *Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis* (No. 77-1645), which involves a decision of the Ninth Circuit and raises important issues similar to those raised by Touche Ross' Petition. Certiorari was granted in *Transamerica Mortgage Advisors* on November 6, 1978, *see* 47 U.S.L.W. 3317, subsequent to the filing of Touche Ross' Petition and reply brief herein.

The issue in *Transamerica Mortgage Advisors* is whether a private right of action may be implied under

Section 206 of the Investment Advisers Act of 1940—the same issue involved in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), and *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), *petition for cert. filed*, 46 U.S.L.W. 3766 (June 1, 1978) (No. 77-1717). The Ninth Circuit in *Transamerica Mortgage Advisors*, 575 F.2d 237 (9th Cir. 1978), held by a 2-1 majority —as did similar 2-1 majorities of the Second Circuit in *Abrahamson* and the Fifth Circuit in *Wilson*—that there was such an implied private right of action.

The grant of certiorari in *Transamerica Mortgage Advisors* is significant here in at least two respects. First, it provides further reasons, in addition to those set forth in Touche Ross' Petition and reply brief, for granting certiorari here. Second, it is clear that this Court's decision in *Transamerica Mortgage Advisors* will have an important bearing on the issues presented by Touche Ross' Petition. Consequently, if the Court is not disposed to grant Touche Ross' Petition at this time so as to permit this case to be considered on the merits concurrently with *Transamerica Mortgage Advisors*, it should not deny certiorari but at most should defer decision on Touche Ross' Petition pending decision in *Transamerica Mortgage Advisors*.

I

The Grant Of Certiorari In *Transamerica Mortgage Advisors* Demonstrates That Certiorari Should Also Be Granted Here

1. *Transamerica Mortgage Advisors* involves important issues similar to those raised here. In both cases, the ultimate issue is the extent to which implied private

rights of action may be judicially created under particular provisions of the federal securities laws—in *Transamerica Mortgage Advisors*, under Section 206 of the Investment Advisers Act, and here, under Section 17 of the 1934 Act. Moreover, in both cases determination of the ultimate issue requires analysis of (a) the limitations imposed upon the implication of private rights of action under the federal securities laws by this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), and (b) the relevance of the criteria adopted by this Court in *Cort* v. *Ash*, 422 U.S. 66 (1975), and subsequent decisions, for determining whether certain statutes create implied private rights of action.

2. The granting of certiorari here would, in view of the grant of certiorari in *Transamerica Mortgage Advisors*, permit this Court to clarify for the lower federal courts (a) the relevance of the *Cort* v. *Ash* analysis in differing statutory contexts, and (b) whether and what differing factors are to be considered in determining the existence of implied private remedies under statutory provisions which, as in *Transamerica Mortgage Advisors*, provide no express remedy whatsoever and those which, as here, already provide an express but limited private remedy.* These questions are

**Transamerica Mortgage Advisors* involves Section 206 of the Investment Advisers Act, a statute for violations of which *no express private remedy whatsoever* is provided, and as to which the existence of any private remedy depends upon judicial implication. On the other hand, this case involves Section 17 of the 1934 Act, a statute for violations of which Section 18 thereof *already provides an express and limited private remedy*, and as to which any judicially-created implied private remedy would go beyond the express remedy that Congress believed appropriate. The distinction is an important one, since *Cort* v. *Ash* by its own terms limits its analysis to determining "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added). 422 U.S. at 78. *See also* Petition, pp. 10-11, 20.

of obvious importance and their relevance is of course not limited to the federal securities laws but extends to any statute allegedly giving rise to implied private rights. Consideration of this case together with *Transamerica Mortgage Advisors* would permit this Court to give comprehensive attention to these questions.

3. The grant of certiorari in *Transamerica Mortgage Advisors* necessarily raises serious questions about the correctness of the decision in *Abrahamson* v. *Fleschner, supra,* since they both involve precisely the same issue and since the majority and dissent in *Transamerica Mortgage Advisors* simply adopted by reference, respectively, the majority and dissenting opinions in *Abrahamson.* In this case, the Court of Appeals majority also expressly relied upon *Abrahamson* (the majority opinion in which was written by Judge Timbers, who also concurred with Judge Lumbard to form the majority here) (9a-10a; *see also* 25a [n. 4]). Consequently, if this Court were to reverse *Transamerica Mortgage Advisors,* it would be clear not only that *Abrahamson* too was wrongly decided, but also that in this case the Court of Appeals majority erred in relying upon *Abrahamson* and thereby erred in its decision.

II

If Touche Ross' Petition Is Not Now To Be Granted, Decision Thereon Should Be Deferred Pending Decision In *Transamerica Mortgage Advisors*

In light of the grant of certiorari in *Transamerica Mortgage Advisors,* this Court—even if it were not disposed to grant certiorari here at this time—should not now deny Touche Ross' Petition. Because of the clearly close relationship of the issues here and in *Transamerica*

Mortgage Advisors, the Court at most should defer decision on Touche Ross' Petition pending disposition of *Transamerica Mortgage Advisors.* After its decision there, and depending upon how that decision affects such pertinent decisions as *Abrahamson* v. *Fleschner,* the Court will be in a better position to determine whether to grant certiorari here or whether to remand to the Court of Appeals for reconsideration in light of the ultimate decision in *Transamerica Mortgage Advisors.*

CONCLUSION

Touche Ross' Petition for a Writ of Certiorari should now be granted. If the Petition is not now granted, decision thereon should be deferred pending decision in *Transamerica Mortgage Advisors.*

November 15, 1978

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IN THE

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October Term, 1978

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EDWARD S. REDINGTON, as Trustee for the Liquidation of the business of WEIS SECURITIES, INC., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

MOTION OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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The American Institute of Certified Public Accountants (the "Institute") hereby respectfully moves, pursuant to Rule 42(3) of the Rules of this Court, for leave to file the attached brief *amicus curiae* in support of the Petition for a Writ of Certiorari in the above captioned case.[1] The Institute is the only national accounting association whose membership is limited to certified public accountants; it has approximately 140,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in pursuit of that purpose, the Institute has come to be accepted as the authoritative source of

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[1] Petitioner has consented to the filing of this brief. Respondents' consent has been requested but refused.

standards and procedures in its field. Most particularly, the Institute develops the Generally Accepted Auditing Standards which form the backdrop of this litigation.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed on auditors under the rubric of Section 17(a) in connection with their performance of engagements governed by such generally accepted auditing standards. The Institute was invited to and did testify before the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act (*Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate*, 73d Cong., 1st Sess., pt. 15 at 7207-10 (1934)) and was accorded permission by this Court to file a brief *amicus curiae* in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976). In light of that interest, the Institute will confine its brief *amicus curiae* to the issue of major significance to the accounting profession as a whole that is presented by the first question tendered in the Petition for Certiorari, which may, for present purposes, be cast as follows:[2]

> Should a private right of action for damages be judicially implied under Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q(a) (the "1934 Act") and Rule 17a-5 promulgated thereunder, 17 C.F.R. § 240.17a-5, in favor of brokerage house customers against accountants in connection with their opinion regarding allegedly false or misleading financial statements of the broker absent any allegation that the customers purchased or sold securities in reliance on the allegedly erroneous statements.

[2] The Institute does not express any position with respect to the other issues presented by petitioners.

The Court below answered this question in the affirmative. That decision represents a jarring departure from the doctrinal development of the law in the area of securities regulation and imposes insupportable risks upon the performance of the audit function. The implications of the holding below that customers who neither purchased nor sold securities in reliance on allegedly erroneous financial statements have standing to invoke a private cause of action under Section 17(a) and of the unsatisfactory analysis upon which that holding was reached, transcend the interests of the parties litigant and are of profoundly disturbing significance to the accounting profession as a whole. The practical consequences of the decision below will be the exposure of auditors to potentially unlimited liability to an indeterminate class.

The decision below expands the scope of remedies for violation of Section 17(a) beyond that specifically provided for by Congress in Section 18. Such expansion is improvident and unwarranted, and its implications are detrimental to the administration of the carefully balanced enforcement scheme based on industry self-regulation, SEC oversight and enforcement, and private remedies, that was enacted and intended by Congress.

The Institute seeks leave to file its *amicus* brief to demonstrate that the implication of a private remedy under Section 17(a) is not required or permitted by any correct interpretation of the statute or the legislative history, is

not consistent with the governing precedents of this Court and is a matter of sufficient doctrinal and practical importance to warrant the issuance of the writ.

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae,* in support of the Petition for a Writ of Certiorari, and urges this Court to review the Opinion and Judgment of the United States Court of Appeals for the Second Circuit entered in these proceedings on April 21, 1978.

Opinions Below

The opinion of the majority of the Court of Appeals (Lumbard and Timbers, CJJ) reversing the decisions of the District Court and remanding the case and the dissenting opinion (Mulligan, C.J.), [Current] CCH Fed. Sec. L. Rep. ¶ 96,404 (2d Cir. 1978), are not yet officially reported and are printed in the Appendix to the Petition for Certiorari. The Opinion of the District Court dismissing the complaint is reported at 428 F. Supp. 483 (S.D.N.Y. 1977).

Question Presented

The Institute as *amicus curiae* addresses solely the first question presented in the Petition for Certiorari.[1] That issue may be restated as follows:

> Should a private right of action for damages be judicially implied under Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q(a) (the "1934 Act") and Rule 17a-5 promulgated thereunder, 17 C.F.R. § 240.17a-5, in favor of brokerage house customers against accountants in connection with their opinion regarding allegedly false or misleading financial statements of the broker absent any allegation that the customers purchased or sold securities in reliance on the allegedly erroneous statements.

Interest of the Institute as *Amicus Curiae*

The Institute is the only national accounting association whose membership is limited to certified public

[1] The Institute has not formulated and does not express any position with respect to the other issues presented by petitioner.

accountants; it has approximately 140,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in the pursuit of that purpose, the Institute has come to be accepted as the authoritative source of standards and procedures in its field. Most particularly, the Institute develops Generally Accepted Auditing Standards which form the backdrop of this litigation.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed on auditors under the rubric of Section 17(a) in connection with their performance of engagements governed by such generally accepted auditing standards. The Institute was invited to and did testify before the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act. *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate*, 73d Cong., 1st Sess., pt. 15 at 7207-10 (1934) (hereinafter cited as *1934 Hearings*).

The implications of the holding below that customers who neither purchased nor sold securities in reliance on allegedly erroneous financial statements have standing to invoke a private cause of action under Section 17(a) and of the unsatisfactory analysis upon which that holding was reached, transcend the interests of the parties litigant and are of profoundly disturbing significance to the accounting profession as a whole. The Institute here contends that the question of whether a private right of action under Section 17(a) may be implied should be addressed at this stage prior to the growth of the acorn planted by the court below into a "judicial oak" of even greater proportions than that which prompted the concern of this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421

U.S. 723, 737 (1975) (*"Blue Chip"*). Since that implication frustrates congressional intent as derived from the statute and legislative history, this Court should, because of its importance to the administration of the securities laws, rule on its propriety.

Statement

Weis Securities, Inc. ("Weis") is a defunct brokerage firm. Pursuant to the provisions of the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa *et. seq.* ("SIPA"), liquidation of Weis was commenced in 1973. The Trustee of Weis Securities and the Securities Investor Protection Corporation ("SIPC") brought this action for damages in 1976 in their own right and respectively as bailee of Weis customers' property and as subrogee of the rights of Weis customers whose claims were paid by SIPC. They alleged that Touche Ross & Co., the accounting firm which audited Weis' financial reports in the years prior to Weis' bankruptcy, rendered a false or misleading opinion regarding Weis' financial statements in violation of Section 17(a) of the 1934 Act and SEC Rule 17a-5. Neither of the plaintiffs, nor the customers whose claims they claim to represent, assert injuries arising out of a purchase or sale of securities. The theory of damages upon which they rely is that Weis' false and misleading financial reports prevented SIPC from taking appropriate actions to ward off financial collapse.[2] The Trustee and SIPC commenced an identical action against Touche Ross & Co. in the New York State Courts

[2] Immediately following the discovery of Weis' financial condition in 1973, the SEC brought an action against Weis and certain of its officers seeking injunctive relief alleging violations of the securities acts. Further, an indictment was filed against former Weis officers in *United States* v. *Arthur Levine, et al.* alleging violations of the securities acts and fraudulent concealment.

alleging common law claims of accountants' negligence and malpractice in July 1975, almost one year prior to the commencement of the federal action.[3]

The majority of the court below determined that a private right of action exists under Section 17(a) of the 1934 Act in favor of brokerage house customers against an accounting firm on the basis of its opinion concerning the broker's allegedly false financial statements, notwithstanding the customers' failure to purchase or sell securities in reliance on those statements. To reach this conclusion the Court of Appeals necessarily and expressly rejected the District Court's holding that Section 18, which provides explicit remedies for violations of the reporting provisions of the 1934 Act, including Section 17(a),[4] is the exclusive source of private remedies for any such violation.

Judge Mulligan forcefully dissented on the grounds that the implication of a private cause of action under Section 17(a) in favor of plaintiffs who would have no standing under Section 18 of the 1934 Act violated this Court's teachings regarding statutory construction and was superfluous in view of state law remedies.

REASONS FOR GRANTING THE PETITION

A.

THE HOLDING BELOW CONFLICTS WITH CONGRESSIONAL INTENT AS ESTABLISHED THROUGH APPLICATION OF GOVERNING PRECEDENTS OF THIS COURT

The implication of a private right of action under Section 17(a) of the 1934 Act finds no warrant in either the

[3] In the state court action, the parties have proceeded with discovery. (Appendix to Petition at 6a, n.7)

[4] Other reporting sections of the 1934 Act are Sections 12(b), 12(g), 13, 15(b)(1), 15(d), 15A(a) and 16(a). They have in common the underlying premise that disclosure be afforded through required filings made with the SEC.

language of that section individually or the provisions of the 1934 Act as a whole. Not a word indicates that any of the reporting sections was intended to afford the basis for civil liability in damages to anyone who could claim to be a beneficiary of those reports. The 1934 Act as a whole represents a sharply drawn Congressional balance apportioning enforcement among administrative regulation, self enforcement and liability to third parties. An examination of the legislative history persuasively shows that Congress, as part of that regulatory scheme, carefully circumscribed private rights of action in a fashion precluding the claims asserted here.

(i) The Text of the Statute Limits Standing to Sue for Violation of Section 17(a) to those Who Purchased or Sold a Security at a Price Affected by the Misstatement

This Court is now called upon to consider yet another attempt to assert privately a cause of action under the 1934 Act. Such an attempt brings to the fore an analytical process in which this Court has taken pains repeatedly to emphasize, particularly with respect to the securities laws, that "[t]he starting point in every case involving construction of a statute is the language itself." *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 472 (1977); *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 197 (1976), quoting *Blue Chip, supra,* at 756 (Powell J. concurring).[5]

The text of Section 17(a), unlike all other sections of the 1934 Act in which private remedies have been implied, does not proscribe as unlawful any conduct whatsoever; it simply sets forth certain bookkeeping and reporting requirements.[6] In Section 18(a), Congress squarely limited

[5] See also, *United States* v. *Bass,* 404 U.S. 336, 339 (1971); Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Colum. L. Rev. 527, 543.

standing to sue for damages attributable to a false or misleading statement filed with the SEC pursuant to the 1934 Act to those "who in reliance upon such statement, shall have purchased or sold a security at a price affected by such statement," 15 U.S.C. § 78r(a). This is the language which Congress employed. Nowhere in the 1934 Act did Congress indicate any intention to expand the contours of a private right of action for violation of Section 17(a) beyond that permitted in Section 18.

Yet the court below dismissed perfunctorily the limitations of Section 18. It ignored the reminders that this Court articulated in both *Blue Chip* and *Ernst & Ernst* v. *Hochfelder* that "the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen. . . ." 425 U.S. at 206, quoting *SEC* v. *National Securities, Inc.,* 393 U.S. 453, 466 (1969).

In *Blue Chip,* this Court found it "anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action [with respect to Rule 10b-5] beyond the bounds it delineated for comparable express causes of action [in Section 18]";[7] the holding below

[6] The Senate Report accompanying the 1975 Amendments (Pub. L. 94-29, 89 Stat. 137) affirms the reporting nature of that Section:

> Section 13 of the bill would amend section 17 of the Exchange Act by deleting subsection (a) and inserting several new subsections concerning the authority of the Commission and the appropriate regulatory agencies to prescribe recordkeeping, reporting and maintenance requirements and to conduct examinations of persons subject to their respective jurisdictions.

S. REP. NO. 94-75, 94th Cong., 1st Sess. 119 (1975).

[7] *Blue Chip, supra* at 736.

The determination below that Congress did not implicitly choose to deny a private right of action under Section 17(a) is based on the court's reasoning that Section 17(a) is distinguishable from the

(footnote continued on following page)

is even more anomalous in that it implied a cause of action beyond the bounds Congress expressly chose to limit that very cause of action.

The reasoning of the court below that Section 18 is not applicable is thus a concession that its holding exceeds the specific terms of the statute sought to be interpreted and from which the implied right of action is said to flow. In view of the clarity of the statutory language, however,

> ". . . and mindful that the language of a statute controls when sufficiently clear in its context, *United States* v. *Oregon,* 366 U.S. 643, 648 (1961), further inquiry may be unnecessary. We turn now, nevertheless, to the legislative history of the 1934 Act to ascertain whether there is support for the meaning attributed to [§ 17] by the [court below]."

Ernst & Ernst v. *Hochfelder, supra* at 201; *see United States* v. *Bass, supra; United States* v. *Campos-Serrano,* 404 U.S. 293, 297-98 (1971); *Toussie* v. *United States,* 397 U.S. 112, 120-22 (1970).

(ii) The Legislative History: Standing to Sue for Violation of Section 17(a) is Sharply Limited

The legislative history overwhelmingly demonstrates that Congress meant what it said in Section 18 in limiting

(footnote continued from previous page)
statutory schemes in cases denying a private remedy where a particular agency was vested with exclusive enforcement. In support, the Court cited *Cort* v. *Ash,* 422 U.S. 66 (1975); *SIPC* v. *Barbour,* 421 U.S. 412 (1975); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) (*"Amtrak"*). *Cort, Barbour* and *Amtrak,* however, do not stand for the proposition, or even suggest, that an implicit congressional intent to deny a private remedy can only be found where the statutory scheme provides an exclusive enforcement mechanism. In each case denying such implicit intent this Court based its decision on a careful analysis of the language and structure of the statute as well as the legislative history. No such analysis was undertaken by the court below.

standing to sue to those who purchased or sold a security at a price affected by a misleading statement filed with the SEC.

Congress considered the wisdom of creating a private right of action for violation of the reporting sections only in connection with fashioning the terms of Section 18. Virtually every version of Section 18 that was presented to the House or Senate limited standing to sue in the same terms as Section 18 in its final form. This consistent uniformity speaks not of indifference to the sharp limitation of the class of plaintiffs who could bring such actions; to the contrary, Congress consciously intended exactly that limitation—a limitation insisted on, for example, by Speaker Rayburn in explaining the very bill he sponsored:

> "Mr. Hollister: The gentleman keeps referring to the issuer or the seller. This is a general clause and covers anybody making any kind of statement in any kind of document or in any kind of paper that is filed. It includes accountants, lawyers, or any other expert.
>
> Mr. Rayburn: No.
>
> • • • • •
>
> [A request of additional time was made]
>
> Mr. Rayburn: I want to read this part of the section to the gentleman:
>
> Who, in reliance upon the statement, shall have purchased or sold a security.
>
> Mr. Hollister: Yes, that is the man who is going to sue. I am talking about the report that is made. This refers to any statement that is made in any report under this bill, if it contains a misleading statement.

> Mr. Rayburn: If upon that report somebody bought or sold a security and lost money relying upon the statement that was false."

78 CONG. REC. 8040 (1934).

That intent could hardly be clearer. In the Senate, it was reenforced by Thomas Corcoran, the author with James Landis and Benjamin Cohen of the 1934 Act. After reading Section 18,[8] Corcoran noted, "That is the provision of the Securities Act toned down a little," clearly referring to the same purchaser-seller limitation found in Sections 11 and 12 of the Securities Act of 1933, 15 U.S.C. §§ 77k and l. *1934 Hearings* at 6564.

Indeed, Congress expressed the concern that, even with the purchaser-seller limitation, the original drafts of Section 18 went too far. Corcoran and others were anguished over a long period of limitations which gave rise to the possibility of "blackmail". *1934 Hearings* at 6565. The Institute expressed its concern over the amount of damages originally provided. *1934 Hearings* at 7207-10. These matters were addressed and Section 18 was accordingly tightened.

The decision below thus enjoys no support in the legislative history.[9] The limitation discarded below was con-

[8] Section 17 of The Fletcher Act which later became Section 18.

[9] In its scanty treatment of the legislative history, the court below cited Exchange Act Releases pertaining to Rule 15c3-1 as support for the conclusion that a private remedy is necessary to accomplish the purposes of Section 17. Beyond the doubtful relevance of the Releases to the issue at hand, one of the Releases, No. 11,497, [1975-76 Tranfer Binder] CCH Fed. Sec. L. Rep. ¶ 80,212, was issued after the effective date of the accrual of the alleged cause of action. While the Institute contends that Section 17 does not provide a private remedy either as originally enacted or amended, such a significant expansion of the legislative scheme should not be undertaken without a thorough analysis of all appropriate sources of legislative intent particularly those related to Sections 17 and 18. In any event the releases can be no broader than the statute itself. *Ernst & Ernst* v. *Hochfelder, supra* at 214.

sciously required in 1934 and not even in 1975, when Congress rewrote Section 17, was that limitation modified.

The 1975 Amendments were in large part adopted in response to the financial collapse of many brokerage firms and the consequent damage resulting to customers from such failures. Congress authorized the SEC to prepare a Study of Unsafe and Unsound Practices of Brokers and Dealers pursuant to Section 11(h) of the Securities Investor Protection Act of 1970, 15 U.S.C. § 78kkk(h), and that report and the *Securities Industry Study Report of the Senate Subcommittee on Securities* (S. Doc. No. 93-13, 93d Cong., 1st Sess. 1973) were the source of the amendments. Yet neither Congress nor the SEC ever suggested that private remedies be granted as a means of protecting broker customers. Rather, Congress sought the achievement of its purposes by strengthening the provisions for SEC oversight and self-regulation of the securities industry:

> "The intent of the bill is not to diminish the role of self-regulation but to strengthen the total regulatory fabric." S. REP. No. 94-75, 94th Cong., 1st Sess. 23 (1975).[10]

Further, by 1975, the SEC itself had brought numerous injunctive actions against violations of Section 17(a), one of which was brought in 1973 against Weis for the very

[10] The Senate Report accompanying the 1975 Amendments (Pub. L. 94-29, 89 Stat. 137) specifically states:

> "[A]s the Advisory Committee on Broker-Dealer Reports and Registration Requirements recommends: '. . . for reporting purposes each broker-dealer [should] be assigned to a designated principal self-regulator or government regulator who will be responsible for determining the broker-dealer's operative and financial status.' Section 17(d) would provide the SEC with unquestioned authority to accomplish these objectives."

S. REP. No. 94-75, 94th Cong., 1st Sess. 33 (1975).

violation at issue here. Thus, in 1975, the SEC was fully aware of the very circumstances which prompted its urging below, as *amicus curiae,* that a private remedy be implied. Nevertheless and notwithstanding the failures of such brokerage firms and the resulting damage to customers, the SEC did not recommend that civil remedies be provided as a necessary supplement to the enforcement mechanisms existing under the statute. Rather, it recommended solely increased SEC oversight and self-regulatory mechanisms.[11]

Moreover, at the time these amendments were considered two district courts had held and the Court of Appeals for the Third Circuit had affirmed that Section 18(a) contained the exclusive remedy for violations of the reporting provisions of the 1934 Act.[12] As this Court reasoned with respect

[11] Moreover, the adoption by the court below of the "administrative deference" rule is misplaced. The Court in *Piper* v. *Chris-Craft Ind.,* 430 U.S. 1 (1977) specifically noted:

> "We note, first, that the present position of the SEC is not consistent with the testimony of the SEC Chairman in the legislative evolution of § 14(e). Even if the agency spoke with a consistent voice, however, its presumed 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants. Indeed, in our prior cases relating to implied causes of action, the Court has understandably not invoked the 'administrative deference' rule, even when the SEC supported the result reached in the particular case. *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964); *Superintendent of Ins.* v. *Bankers Life & Cas. Co.,* 404 U.S. 6 (1971). 430 U.S. at 41, n.27.

[12] Section 18(a) was held to be the exclusive "catchall" civil liability provision for all the reporting requirements of the Exchange Act in *In re Penn Central Securities Litigation,* 347 F.Supp. 1327, 1339-40 (E.D. Pa. 1972), *modified on other grounds,* 357 F.Supp. 869 (E.D. Pa. 1973), *aff'd,* 494 F.2d 528 (3d Cir. 1974). *Accord, duPont* v. *Wyly,* 61 F.R.D. 615, 628, *adhered on reargument,* 61 F.R.D. 632 (D. Del. 1973). In concluding that Section 18(a) was

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to the closely related *Birnbaum* rule limiting standing to sue under Rule 10b-5 to purchasers or sellers of securities, Congress's failure to reject this interpretation "argues significantly in favor of [its] acceptance." *Blue Chip, supra* at 733.

(iii) The Extrinsic Evidence From the Texts of Other Sections of the 1934 Act and of the 1933 Act Show the Error of the Holding Below

The interrelated nature of the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (the "1933 Act"), and the 1934 Act makes instructive an examination of the limitations on civil liability found in those provisions in creating a private cause of action where Congress did not so provide. *Blue Chip, supra* at 727-730.

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the exclusive remedy for violation of Section 13(a), the court in *Penn Central* specifically stated:

> "Where Congress has specifically authorized a remedy for violation of an act, the courts should not nullify the congressional scheme by implying a right of action on behalf of those not otherwise entitled to recover." 347 F.Supp. at 1340.

Since the enactment of the 1975 Amendments, the *Penn Central* holding has been followed in seven district court cases. *Dewitt* v. *American Stock Transfer Co.,* 433 F.Supp. 994, 1005 (S.D.N.Y. 1977) (no implied private damage action for violations of §§ 13(a) and 15(d)); *Lewis* v. *Elam,* [1977-78 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 96,013 (S.D.N.Y. 1977) (§ 13(a)); *Levy* v. *Johnson,* [1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,899 (S.D.N.Y. 1977) (§ 13(a)); *McLaughlin* v. *Campbell,* 410 F.Supp. 1321 (D. Mass. 1976) (§§ 13(a), 20(b), 20(c)); *Meer* v. *United Brands Co.* [1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶95,648 (S.D.N.Y. 1976) (§ 13(a)); *Myers* v. *American Leisure Time Enterprises, Inc.,* 402 F.Supp. 213 (S.D.N.Y. 1975), *aff'd by oral opinion,* 538 F.2d 312 (2d Cir. 1976) (§ 13(d)); *In re Equity Funding Corp. of America SEC Litigation,* 416 F.Supp. 161, 190-91 (C.D. Cal. 1976) (§ 13 has ultimate purpose of investor protection; although a duty to file accurate and complete reports can be implied from the filing requirements, the "sense" of the statute and rules is that they are administrative devices and are not intended to provide private rights to investors, except as might be narrowly provided for in § 18).

Congress did not set the boundaries of civil liability at random. Rather, as this Court noted in *Blue Chip, supra* at 728, in each instance where Congress imposed civil liability in the 1933 Act it limited the class of plaintiffs to those who suffered a loss related to a securities transaction. The same limitation is found in Section 9(e) of the 1934 Act. The private right of action there enacted employs exactly the same transactional requirement found in Section 18. *Blue Chip, supra* at 736. And the "in connection with" language of Section 10(b) has been interpreted by this Court in *Blue Chip* similarly to require standing as a purchaser or seller.[13]

The decision below is thus a considerable departure from this uniformity found in the other sections of this intergrated regulatory scheme as well as a judicial subversion of the terms and intent of Section 18 itself. It squarely conflicts with the governing decisions of this Court and should be reviewed.

B.

CERTIORARI IS REQUIRED BECAUSE OF THE IMPORTANCE OF THE ISSUE TO THE ADMINISTRATION OF THE SECURITIES LAWS

It is one thing to posit civil liability in damages on the basis of fraud in connection with a securities transaction. It is another to hold that anyone who Congress

[13] This Court's decision in *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) is entirely consistent with the transactional limitations expressly created by Congress. There, this Court held that a recipient of a proxy statement may assert a private cause of action based on a material misstatement contained in that proxy statement in violation of Section 14(a) of the 1934 Act. Such a statement is designed, like a statement made in connection with a purchase or sale of a security (§ 10(b)) and like a statement which influences the price of a security purchased or sold by the plaintiff (§§ 9(e) and 18), to influence the receiver to act. He is thus in a position closely analogous to those whom Congress expressly empowered to sue.

thought might derive some benefit from a report required to be filed with the SEC may sue under the 1934 Act for whatever damages he may incur regardless of the absence of any connection with a securities transaction. And it is quite another thing to imply such liability, not just on the part of registered brokers and companies and those persons responsible for such reports, but on the part of auditors who are one step further removed from the registrant and who render their opinion with respect to financial statements included in such reports. This, with respect to the reporting requirements to which every registered brokerage house and every registered company are subject, presents that stark spectacle portrayed by Chief Judge Cardozo 47 years ago and recently rejected by this Court: "a liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931), quoted in *Blue Chip, supra* at 748. As such, it far exceeds the situation in *Blue Chip* where this court dismissed, for similar reasons, the claims under Rule 10b-5 of persons allegedly deceived into holding their securities.

Here, moreover, the exposure of auditors to potentially unlimited liability to an indeterminate class particularly should be avoided since the contours of such liability have not been established. This Court, in determining the appropriate standards of civil liability for violations of the antifraud provisions where a cause of action has been implied, has sought a firm basis for the definition of such standards in both the statutory language and the legislative history. *Ernst & Ernst* v. *Hochfelder, supra.* The language of Section 17(a) and its legislative history provide no such basis upon which those who would be subject to liability could find guidance, and judicial articulation of such standards would be void of Congressional guidance.

It should be self-evident that the process of auditing the financial statements of a company does not yield absolute certitude about the result. The audit function proceeds very largely upon the exercise of judgment and by a process of sampling which in turn rests upon the experience, expertise and informed judgment of the auditor. The product of the audit, as reflected in the auditor's opinion is again a matter of judgment. Such an indeterminate liability should not be imposed on that process.

The court below took that further step, concluding that since "neither SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost," a private right of action against the auditors as the remaining solvent party should be implied. This conclusion misapplies the requirement of "necessity" articulated in *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), as explained in *Piper* v. *Chris-Craft Ind.,* 430 U.S. 1 (1977):

> "The reasoning of these holdings is that, where congressional purposes are likely to be *undermined* absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute." 430 U.S. at 25. (Emphasis supplied).

This principle was reaffirmed in *Santa Fe Industries, Inc.* v. *Green, supra* at 477:

> ". . . we have also recognized that a private cause of action under the antifraud provisions of the Securities Exchange Act should not be implied where it is 'unnecessary to ensure the fulfillment of Congress' purposes' in adopting the Act."

Section 17(a) is not an antifraud provision nor was it enacted for the broad remedial purposes which this Court

has attributed to the antifraud provisions. To be sure, Section 17(a) was enacted for the ultimate purpose of protecting investors. But it does not follow that an implied right of action is "necessary" to effectuate that purpose. The purpose of the reporting provisions as well as of the net capital rule, 17 C.F.R. § 240.15c3-1, is to prevent broker failures and to keep the SEC, as well as customers, apprised of the financial status of brokerage firms. H. Rep. No. 91-1613, 91st Cong., 2d Sess. (1970). Together they provide an early warning system to alert the SEC to the financial status of brokers in order that measures might be timely taken to ward off financial collapse. To enforce these provisions, the courts are empowered both to enjoin violations and to impose criminal penalties for violations. 15 U.S.C. §§ 78u(e), 78aa. The deterrent value of the threat of damage awards over and above the sanctions presently provided for is speculative at best. *Cf. Piper* v. *Chris-Craft Ind., supra* at 40. Denial of relief to broker's customers under Section 17(a) will not "undermine" Congress' purposes; nor would granting such relief ensure the fulfillment of those purposes.

Moreover, no explanation is given for the creation of a federal remedy, and its concomitant burden on the federal courts, in view of the state law remedies noted in the dissenting opinion of Judge Mulligan. Plaintiffs, in fact, commenced an action for damages in the state courts of New York prior to the commencement of the federal action. No additional federal remedy is necessary to redress their alleged injuries and "the result would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation." *Santa Fe Industries, Inc.* v. *Green, supra* at 478.

This Court has frequently granted certiorari to review cases where the issue involved was important to the admin-

istration of the federal securities laws. *See Santa Fe Industries, Inc.* v. *Green, supra* at 471; *Ernst & Ernst* v. *Hochfelder, supra; Blue Chip, supra.* Where review was necessary to correct an important doctrinal problem, this Court has not hesitated to do so despite the nonfinality of the judgment sought to be reviewed. *E.g., Blue Chip, supra; Ernst & Ernst* v. *Hochfelder, supra; United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837 (1975).

The general issue of whether a private right of action may be implied under Section 17 was reserved by this Court in *Ernst & Ernst* v. *Hochfelder, supra* at 194 n. 13. Now is the time for its resolution. The holding below goes far beyond merely permitting a private cause of action under Section 17(a); it nullifies the purchaser-seller limitation imposed under Section 18(a). The gravity of the implications of the decision below to the administration of the carefully balanced enforcement scheme based on industry self-regulation, SEC oversight and enforcement, and private remedies, enacted and intended by Congress, dictate that the decision below should be reviewed at this time by this Court.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Supreme Court, U. S.
FILED
JAN 23 1979
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

— *v.* —

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 23, 1978
CERTIORARI GRANTED NOVEMBER 27, 1978

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Relevant Docket Entries

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

DATE 1976	PROCEEDINGS
4-30	Filed complaint. Issued summons.
5-20	Filed summons with marshals return. SERVED: TOUCHE ROSS & CO. on 5-12-76.
6-07	Filed stp & order that the time of deft to answer etc, is extended to 6-23-76, Wyatt, J.
6-09	Filed Notice that pltff will take deposition of Karl Brunhuber on 6-21-76 as indicated.
7-12	Filed Stip & Order that the time for dft. to answer complaint is extended to 7-13-76. . . . Ward J.
7-21	Filed Notice of Appearance of Rosenman Colin Freund Lewis & Cohen. as indicated.
7-23	Filed pltffs first set of interrogatories.
7-27	Filed stip & order that the time for deft to move etc, is extended to 9-15-76, etc, as indicated. Conner J.
8-24	Filed defts objections and answers to interrogatories to pltff.
9-07	Filed pltffs Affidavit & Notice of motion for an order striking defts blanket objections to pltffs, first set of interrogatories, etc, as indicated rtble before Mag. Schreiber on 9-21-76.
9-07	Filed pltffs memorandum of law as indicated.
9-22	Filed defts Affidavit & Notice of Motion for an order dismissing this action etc, as indicated rtble on 10-1-76.
9-22	Filed memorandum of deft Touche Ross & Co. in support of motion to dismiss, etc, as indicated.
9-23	Filed stip & order that the deposition of Karl Brunhuber is adjourned to 10-20-76, and pltffs motion is adjourned to a mutually convenient date to be determined after consultation with Mag. Schreiber. Wyatt, J.
9-30	Filed defts Affidavit in opposition to the motion of the pltffs etc, as indicated.
9-30	Filed defts memorandum in opposition to pltffs motion to compel further discovery.

DATE [1976]	PROCEEDINGS
11-15	Filed stip & order that pltffs shall have to 1-7-77 to serve papers with respect to defts motion of 9-15-76 to dismiss or stay this action etc, as indicated, Wyatt, J.
1977	
1-10	Filed affidavit in opposition to motion to dismiss.
1-10	Filed pltffs memo in opposition to motion to dismiss.
1-10	Filed memorandum of pltff's Securities Investor Protection Corp. in opposition to deft's motion to dismiss.
1-10	Filed pltff's Securities Investor Protection Corp. affdvt. in opposition to deft's motion to dismiss complaint.
2-07	Filed defts. reply affdvt. to dismiss the complaint and for related relief.
2-07	Filed defts. reply memorandum of deft. Touche Ross & Co., in support of motion to dismiss and for related relief.
2-14	Filed Pltffs. Redington, sur-reply memorandum of law.
3-01	Filed Opinion #45650 There can be no jurisdiction simply because SIPC was created by Act. of congress because there is no stock ownership in SIPC by the United States. Finally, the Trustee is a citizen of New York and is a pltff. along with SIPC. Partners of Touche, the deft. are citizens of N.Y. Thus, there is no complete diversity of citizenship within the rule of Strawbridge v. Curtiss, 3 Cranch 267 (1806). The fifth, sixth, seventh, and eight[h] claims of SIPC must be dismissed for lack of jurisdiction over the subject matter . . . . . So Ordered . . . WYATT, J. Settle order and judgment on notice. m/n
3-15	Filed Order & Judgment this action is dismissed, and deft. have judgment against pltffs, and each of them, dismissing this action . . . So Ordered . . . . . WYATT, J. Judgment Ent. on 3-15-77 . . . m/n

DATE [1977]	PROCEEDINGS
4-13	Filed Pltffs. Edward S. Redington, notice of appeal to the U.S.C.A. from the order & Judgment Ent. in this action on the 15th day of March 1977 . . Mailed All Copies.
4-14	Filed Pltffs. Securities Investor Protection Corp. notice of appeal to the U.S.C.A. from the order & Judgment Ent. in this action on the 15th day of March 1977 . . . Mailed all copies.
5-13	Filed stipulation designating a copy of an originally filed document to become part of the record on appeal.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

DATE	FILINGS—PROCEEDINGS
4-14-77	Filed copies of docket entries and notice of appeal (Edward S. Redington)
4-14-77	Filed copies of docket entries and notice of appeal (Securities Investor Protection Corporation)
5-13-77	Filed record (original papers of district court)
7-12-77	Filed briefs, appellant, p/s (Redington)
7-12-77	Filed briefs, appellant, p/s (SIPC)
7-12-77	Filed joint appendix, appellants, p/s
8-22-77	Filed motion for leave to file brief amicus curiae, p/s (S.E.C.) (& in 77-7186)
8-25-77	Received stipulation consenting to the filing of the S.E.C. amicus brief and for a modified scheduling order, appellee, p/s (& in 77-7186)
8-31-77	Filed order granting motion for leave to file a brief as amicus curiae on consent. Further ordered that appellees shall file a brief by 9-23-77, reply brief, if any, by 10-25-77, appeal ready to be heard during the week of 11-7-77. Appellees shall deliver to appellants copy of galley or page proof of its brief by 9-20-77
8-31-77	Filed brief, amicus curiae, p/s (SEC)
9-28-77	Filed printed briefs, appellee, p/s

DATE	FILINGS—PROCEEDINGS
10-25-77	Filed reply briefs, appellant, p/s (& in 77-7186)
10-25-77	Filed reply brief, appellant, p/s (Sec. Investor etc.) (& in 77-7186)
11-14-77	Argument heard (By: Lumbard, Mulligan, Timbers, CJJ) (& in 77-7186)
4-21-78	Judgment reversed as to both plaintiffs and remanded-Lumbard, C.J.
4-21-78	Concurring in separate opinion—Timbers, C.J.
4-21-78	Dissenting in separate opinion—Mulligan, C.J.
4-21-78	Filed judgment
5-5-78	Filed petition for rehearing and rehearing en banc, appellee, pfs
7-7-78	Filed order denying petition for rehearing
7-7-78	Filed order denying petition for rehearing en banc
7-13-78	Filed motion for leave to stay issuance of mandate, appellee, pfs
7-17-78	Filed memorandum in opposition to motion for leave to stay mandate, appellant, pfs
7-21-78	Filed reply to memorandum in opposition to motion for leave to stay mandate, appellee, pfs
7-24-78	Filed order granting motion for leave to stay issuance of mandate
8-23-78	Filed notice of filing petition for writ of certiorari (S.C. #78-309)
9-25-78	Filed notice of filing petition for writ of certiorari (Redington) S.C. #78-493
9-29-78	Filed notice of filing petition for writ of certiorari (Securities Investor Protection Corp.), S.C. #78-526
12-4-78	Filed certified copy of order granting petition for writ of certiorari (S.C. #78-309)

Complaint

Filed April 30, 1976, Served May 12, 1976

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.,

Defendant.

76 Civ. 1981 (IBW)

COMPLAINT

PLAINTIFFS DEMAND A TRIAL BY JURY

Plaintiffs EDWARD S. REDINGTON, Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, by their respective attorneys, complaining of the Defendant, allege as follows:

JURISDICTION AND VENUE

1. This action arises under the Securities Exchange Act of 1934 (15 U.S.C. Sections 78a *et seq.*) (hereinafter the "1934 Act") and particularly under Section 17 thereof (15 U.S.C. Section 78q), the Securities Investor Protection Act of 1970 (15 U.S.C. Section 78aaa *et seq.*) (hereinafter the "1970 Act"), and the common law.

2. This Court has jurisdiction over Plaintiff Redington's claims by virtue of Section 27 of the 1934 Act (15 U.S.C. Section 78aa); Section 6 of the 1970 Act (15 U.S.C. Section 78fff); Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. Sections 11a(7), 502 and 515); Sections 1331 and 1334 of the United States Judicial Code (28 U.S.C. Sections 1331 and 1334); and principles of pendent jurisdiction. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

3. This Court has jurisdiction over the claims of Plaintiff Securities Investor Protection Corporation by virtue of Section 27 of the 1934 Act (15 U.S.C. Section 78aa), Sections 1331 and 1332 of the United States Judicial Code (28 U.S.C. Sections 1331 and 1332), and principles of pendent jurisdiction. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

4. Defendant has its principal place of business in this District and most of the acts alleged herein occurred in this District.

PARTIES

5. Plaintiff Edward S. Redington (hereinafter the "Trustee"), pursuant to the 1970 Act, was duly appointed by Order of this Court dated May 30, 1973 as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), has duly qualified, and is presently acting in such capacity. Section 6(b)(1) of the 1970 Act (15 U.S.C. Section 78fff(b)(1)) provides that a trustee appointed under the 1970 Act shall be vested, *inter alia*, with the same powers and title with respect to the debtor and the property of the debtor as a trustee in bankruptcy and a trustee under Chapter X of the Bankruptcy Act (11 U.S.C. Sections 501-676) have with respect to a bankrupt and a Chapter X debtor.

6. Plaintiff Securities Investor Protection Corporation (hereinafter "SIPC") is a non-profit membership corporation created by and organized under the 1970 Act whose members are, with certain statutory exceptions, all persons registered as broker-dealers under Section 15(b) of the 1934 Act (15 U.S.C. Section 78o(b)) and, with certain statutory exceptions, all persons who are members of a national securities exchange. SIPC has its principal place of business in the District of Columbia. At all relevant times Weis was a member of SIPC.

7. Defendant Touche Ross & Co. ("Touche Ross") is a partnership of certified public accountants with its principal place of business at 1633 Broadway in the City, County and State of New York. In or about 1969 Touche Ross was engaged by Weis as its independent certified public accounting firm, and Touche Ross continued to act in such capacity from about 1969 until about May 1973, when the forced liquidation of Weis commenced.

COMMON ALLEGATIONS

8. At all relevant times prior to May 30, 1973, Weis was a corporation registered as a broker-dealer with the Securities and Exchange Commission (the "SEC") and was engaged in the business of a broker-dealer in securities. From June 1965 until May 1973, Weis was a member of the New York Stock Exchange, Inc. (the "Exchange"), the self-regulatory organization designated by SIPC to examine Weis for compliance with the applicable financial responsibility rules which are imposed on broker-dealers pursuant to Section 6 of the 1934 Act (15 U.S.C. Section 78f) for the protection of the public as a minimum prerequisite for conducting a securities brokerage business.

9. For each of its four fiscal years 1968 through 1971 (ended May 31), Weis' audited financial statements reflected a profit. During early 1972 five of Weis' officers

(the "Weis Five") became increasingly concerned that a fair and accurate presentation of Weis' results of operations for fiscal year 1972 would reflect that Weis was operating at a loss.

10. The Weis Five misstated the financial condition and results of operations of Weis in financial reports prepared at fiscal year-end 1972. These reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders. Such misstatements were accomplished, by *inter alia,* materially overstating assets, creating non-existent assets, understating liabilities, overstating income, and understating expenses. The purpose and effect of such material misstatements were, *inter alia,* to create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000 before taxes whereas in truth and in fact Weis had actually suffered losses in that period in excess of $1,500,000.

11. Had Weis' actual financial condition, its actual results of operations, and the misstatements in its books and records been truthfully reported at the end of Weis' 1972 fiscal year, Weis' 1973 forced liquidation under the 1970 Act would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved by a number of means including, *inter alia,* change in Weis' management, reversal of its policy of growth and expansion, curtailment or contraction of certain of its operations and business practices, gradual liquidation of some or all of its operations, or merger with another securities firm. Moreover, if a liquidation of Weis had been necessary as the result of such truthful reporting, such liquidation could have

occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later.

12. The incorrect and incomplete fiscal 1972 year-end reports prepared by or under the direction of the Weis Five were certified by Touche Ross as being correct and complete. Consequently, the doctoring of Weis' books, records and required reports, the deterioration of its financial condition and the violations of financial responsibility rules could not be nipped in the bud at a time when a forced liquidation of Weis could still have been avoided. Instead, during Weis' fiscal year 1973, Weis' financial condition deteriorated further as the Weis policy of expansion continued unabated. Weis incurred substantial operating losses, depletion of its assets, and depletion of the property held by Weis in trust for its customers. The Weis Five continued to make false and fictitious entries in Weis' books and records, and continued directly or indirectly to submit false reports to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders in order to conceal Weis' true financial condition.

13. Not until April and May of 1973, as a result of separate investigations by the Exchange and the SEC, did the misstatement of Weis' financial condition come to light. These investigations gradually revealed violations of financial responsibility rules, Weis' unsafe, unsatisfactory and deteriorating financial condition, and the lack of accuracy and reliability of any of its financial statements, including those certified by Touche Ross. These revelations and the resulting uncertainties with respect to Weis' true financial condition prevented Weis from being saved as a going concern or being merged with another, financially more secure, brokerage firm, and resulted in Weis' forced liquidation under the 1970 Act.

14. On May 24, 1973, the SEC commenced an action in this Court (73 Civ. 2332) against Weis and the Weis Five for injunctive relief to prevent them from conducting the business of Weis in violation of the 1934 Act and the rules and regulations promulgated thereunder. Also on May 24, 1973 (the "Filing Date"), pursuant to Section 5(a)(2) of the 1970 Act (15 U.S.C. Section 78eee (a)(2)), SIPC applied in this Court for a decree adjudicating that the customers of Weis were in need of the protection of the 1970 Act. On May 30, 1973 (the "Date of Adjudication") such a decree was granted, the liquidation of Weis was ordered, and Plaintiff Edward S. Redington was appointed Trustee for the liquidation of the business of Weis.

15. Upon the entry of the decree referred to in the preceding paragraph, SIPC was required by the 1970 Act to provide, and did provide to the Trustee, funds for the payment of claims submitted by customers and certain other creditors of Weis and for certain administrative expenses of the liquidation.

16. At all relevant times, Defendant Touche Ross held itself out to Weis, the SEC, SIPC, the Exchange and the general public as possessing the ordinary skill, ability and expertise of certified public accountants in accounting and auditing matters, and as being qualified, *inter alia,* (i) to examine and audit the books, records and accounts of firms engaged in the securities business in accordance with generally accepted auditing standards, (ii) to express opinions with respect to the financial statements of such firms as fairly reflecting their financial condition and results of operations in accordance with generally accepted accounting principles, and (iii) to prepare and assist in the preparation of the reports concerning such books, records, accounts and opinions required by Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder. Touche Ross further

held itself out as being familiar with accounting and auditing practices and standards required by the SEC and the Exchange for firms engaged in the securities business.

17. From approximately 1969 until the Date of Adjudication, Touche Ross was engaged by Weis for valuable consideration to serve as Weis' independent certified public accounting firm. During this period Touche Ross agreed to conduct annual audits of the affairs of Weis and to issue opinions and prepare reports on its financial statements, all in accordance with Section 17 of the 1934 Act (15 U.S.C. Section 78q), generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the SEC and the Exchange. In accepting said engagement, Touche Ross agreed to perform said services in a thorough, proper, skillful and diligent manner.

18. Weis and its Board of Directors, customers, creditors, lenders and shareholders, and the SEC, the Exchange and SIPC relied on Touche Ross to apply the standards and expertise, to express the opinions, to make the certifications and to prepare or assist in the preparation of the reports discussed in paragraphs 16 and 17, *supra*, for the purposes, among others, of (i) protecting Weis from fraudulent activity of its officers, directors, agents, and employees; (ii) safeguarding the existence and use of Weis' assets; (iii) assuring the accuracy of financial data submitted directly or indirectly to the Exchange, the SEC and SIPC, and generally made available to the public; (iv) determining whether Weis could continue to engage in business as a broker-dealer in securities; (v) determining whether or not significant restrictions and alterations in the scope and nature of its operations would be required in order for Weis to continue to engage in business as a broker-dealer; and (vi) making informed business decisions concerning the future operations of Weis on the basis of accurate financial information.

19. In or about late 1971 or early 1972, Touche Ross agreed with Weis to perform the aforementioned auditing and accounting services for the year 1972. Among other things, Touche Ross agreed (a) to prepare, cause to be prepared, and assist in the preparation of financial statements of Weis and to issue opinion letters with respect to said statements; (b) to audit the affairs of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations promulgated by the Exchange and the SEC pursuant to Sections 6 and 17 of the 1934 Act (15 U.S.C. Sections 78f and 78q); (c) to notify the Exchange promptly that such audit had been commenced; (d) To prepare an answer to the financial questionnaire (the "Answers to the Financial Questionnaire") of the Exchange based upon said audit; (e) to submit to the Exchange (i) a copy of the Answers to the Financial Questionnaire, (ii) an attestation that the requirements of the audit regulations had been observed in the conduct of the audit, and (iii) a statement that Touche Ross had made a review of Weis' accounting system, internal accounting control, and procedures for safeguarding securities; (f) to furnish to the Exchange comments relative to any material inadequacies found to exist in Weis' accounting system, internal accounting control, and procedures for safeguarding securities; and (g) to indicate any corrective action taken or proposed.

20. Weis' employment of Touche Ross as its independent certified public accounting firm was not merely a matter of private contract between Weis and Touche Ross, but was required by the Exchange pursuant to its duty under Section 6 of the 1934 Act (15 U.S.C. Section 78f) to regulate its members' conduct of their businesses and supervise their financial condition for the benefit of the public. Touche Ross knew or should have known that Weis' engagement of an independent certified public

accounting firm was a requirement of the Exchange and that it was for the benefit both of Weis in making decisions with respect to the operation of its business and of persons other than Weis.

21. Touche Ross' examination of and report on Weis' financial condition were not intended solely for the benefit of Weis but were, pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, intended for and submitted directly or indirectly to, *inter alia*, the SEC, the Exchange, SIPC, and Weis' customers, creditors, lenders and shareholders. The Exchange was the organization designated and relied upon by SIPC to examine Weis for compliance with the applicable financial responsibility rules and to alert SIPC of Weis' financial difficulty.

22. Touche Ross knew or should have known that its examination of and report on Weis' financial condition were a requirement of Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, and were for the benefit both of Weis and of persons other than Weis.

23. In accordance with its engagement agreement, Touche Ross purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972 and in connection therewith (a) certified, prepared, caused to be prepared, and assisted in the preparation of financial statements of Weis; (b) certified and prepared Weis' Answers to the Financial Questionnaire; and (c) issued four opinion letters (the "1972 Opinion Letters") to the Board of Directors of Weis dated, respectively, July 7, 1972, July 7, 1972, July 21, 1972 and July 21, 1972.

24. By means of the foregoing, Touche Ross represented and certified that it had examined (i) the statement of Weis' financial condition as of May 26, 1972, (ii) Weis' Answers to the Financial Questionnaire as of May 26, 1972, (iii) Weis' consolidated balance sheet for the 52

weeks ended May 26, 1972, and (iv) Weis' consolidated statement of earnings for the five years ended May 26, 1972. The letter pertaining to the Answers to the Financial Questionnaire stated that the Touche Ross examination had been made "in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof . . . as [Touche Ross] considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission." The letter also stated that the Answers to the Financial Questionnaire presented fairly the financial position of Weis at May 26, 1972 in the form prescribed by the Exchange and the SEC in conformity with generally accepted accounting principles applied on a consistent basis. Each of the other three 1972 Opinion Letters stated that the Touche Ross examination had been conducted in accordance with generally accepted auditing standards and that the aforementioned financial statements presented fairly the financial position of Weis and subsidiaries at May 26, 1972, and the results of operations and changes in their financial position for the year and the five years then ended, in conformity with generally accepted accounting principles applied on a consistent basis. (The 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements are annexed hereto as Exhibits A, B, C and D.)

25. Touche Ross knew, should have known and intended that Weis and its Board of Directors would rely on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements for various purposes, including those set forth in paragraph 18, *supra*.

26. Touche Ross knew, should have known and intended that the SEC, the Exchange and SIPC would rely on the 1972 Opinion Letters and accompanying Answers

to the Financial Questionnaire and financial statements in carrying out their respective regulatory, supervisory and protective duties with respect to Weis, in determining whether Weis was in compliance with the applicable financial responsibility rules, and in determining whether Weis was in financial difficulty.

27. Touche Ross knew, should have known and intended that Weis' customers, creditors, lenders and shareholders would rely directly or indirectly on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in making decisions whether to commence or continue their respective relationships with Weis.

28. Touche Ross breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner in that, among other things, it:

a. failed to audit, verify and examine the books, records, accounts and financial statements of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC;

b. failed to prepare, cause to be prepared, and assist in the preparation of accurate financial statements of Weis and Weis' Answers to the Financial Questionnaire;

c. rendered the 1972 Opinion Letters, which were false, inaccurate and incomplete;

d. failed properly to test, study and evaluate Weis' system of internal accounting control;

e. failed to obtain competent evidential matter sufficient to afford a proper basis for the 1972 Opinion Letters;

f. falsely certified that it had examined Weis' books and records in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and SEC; and

g. failed to inform or otherwise alert Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC) (i) of the material errors in Weis' Answers to the Financial Questionnaire and in Weis' financial statements prepared in connection with the 1972 Touche Ross audit; (ii) of the existence of inaccurate and unreliable books and records with respect to Weis; or (iii) of the possibility that Weis was facing financial difficulty.

29. Specifically, among other things, Touche Ross failed properly to audit, verify and examine:

(a) the Scheinman Hochstin & Trotta liquidation omnibus account (the "SH&T Omnibus Account"), a claimed asset of $745,000. If Touche Ross had audited, verified and examined the SH&T Omnibus Account in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that in or about April 1972 the SH&T Omnibus Account had been debited in the amount of approximately $625,000;

(2) that, contrary to generally accepted accounting principles, the offsetting credits for this debit were to one or more income accounts;

(3) that the purpose and effect of these improper credits were to overstate Weis' gross income by approximately $625,000 and its net income and net worth by approximately $312,500; and

(4) that an overstatement by this amount was a material overstatement because it constituted over 30% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and over 4% of Weis' claimed net worth as of that date.

(b) the Winslow, Cohu & Stetson ("WC&S") insurance claim receivable, a claimed asset of $1,285,000. If Touche Ross had audited, verified and examined the WC&S insurance claim receivable in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that, on or about May 8, 1972, the WC&S insurance claim receivable had improperly been increased in value (debited) from $600,000 to $785,000 because of interest purportedly payable on the claim;

(2) that, on or about May 25, 1972, the WC&S insurance claim receivable had improperly been further increased in value (debited) to $1,285,000 because of a purported increase in the value of the claim;

(3) that, contrary to generally accepted accounting principles, the offsetting credits for these two debits had been made to various income accounts;

(4) that the purpose and effect of these improper transactions were to overstate Weis' gross income by approximately $685,000 and its net income and net worth by approximately $342,500;

(5) that an overstatement by this amount was a material overstatement because it constituted nearly 35% of Weis' claimed net income for the entire fiscal

year ended May 26, 1972 and approximately 4.5% of Weis' claimed net worth as of that date.

(c) other false, fraudulent and improper entries, irregularities and accounting transactions in the books of Weis which included, *inter alia,* the following:

(1) The re-depositing into income accounts of at least $800,000 worth of checks which were purportedly drawn to pay vendors or other creditors, thus overstating Weis' net income and net worth by at least $400,000;

(2) The doubling (to approximately $432,000) of accrued commission income for May 22-26, 1972, thus overstating Weis' net income, net worth, and net capital by approximately $108,000;

(3) The improper crediting of income accounts with proceeds from a sale-leaseback transaction, thus overstating Weis' net income and net worth;

(4) The improper transfer of certain short security positions to dividend receivable accounts;

(5) The improper failure to record certain liabilities of Weis on the books of Weis;

(6) The manipulation of certain error accounts to reflect false credit balances of $100,000 to $200,000, which then were taken into income, thus overstating Weis' net income, net worth and net capital by approximately $50,000 to $100,000;

(7) The improper designation of up to $500,000 worth of miscellaneous receivables as "current" so that it was not necessary to deduct them from capital in computing Weis' net capital ratio under Exchange

Rule 325, with the result that Weis' net capital ratio was made to appear to be below 10:1 and Weis thus was not precluded by Exchange Rule 326 from expanding its business.

30. Upon the discovery by Touche Ross of any one or more of the false entries or improper accounting transactions discussed in paragraph 29 above, Touche Ross would have had an obligation to report such discoveries, *inter alia,* to Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC); and it would have had an obligation to report such discoveries in the 1972 Opinion Letters and to refrain from issuing the 1972 Opinion Letters in the form they actually took.

31. As a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC:

a. the acts of the Weis Five as set forth in paragraphs 10 through 13 herein were not promptly discovered, and the Weis Five were able to continue to make false and fictitious entries in Weis' books, records and financial statements in order to conceal Weis' true financial condition during its fiscal year 1973;

b. other misstatements and inaccuracies in Weis' books, records and financial statements were not discovered;

c. Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules;

d. Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from (i) knowing the true financial condition of Weis, (ii) performing their respective duties to safeguard the assets of Weis and the property Weis was holding in trust for its customers, (iii) taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis under the 1970 Act could have been prevented, and (iv) taking or causing to be taken appropriate and immediate action to avoid or reduce the costs of satisfying the claims of Weis' customers;

e. the acts of the Weis Five as set forth in paragraphs 10 through 13 herein were not discovered by Weis, its Board of Directors, the SEC, SIPC or the Exchange until April and May 1973 at which time the only remedial action that could be taken was the forced liquidation of Weis under the 1970 Act, which caused and continues to cause substantial injury to Weis and SIPC as well as Weis' customers, creditors, lenders and shareholders;

f. the assets of Weis and the property Weis was holding in trust for its customers were not on the Filing Date or thereafter sufficient to satisfy the claims of Weis' customers, creditors, lenders and shareholders;

g. Weis was unable to comply with the minimum financial responsibility rules which would allow it to conduct its business as a broker-dealer in securities, was unable to restore itself to a condition in which it could remain in business, and lost the value of its business and assets as a going concern;

h. the assets of Weis were wasted and mismanaged; and

i. Weis was caused to undertake financial obligations which it could not satisfy and which it would not or could not have undertaken had its true financial condition as of May 26, 1972 been known to Weis and its Board of Directors, the SEC, the Exchange and SIPC.

As And For Plaintiff Trustee's First Cause Of Action

32. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

33. As a result of the errors and omissions of Touche Ross, including those set forth in paragraphs 28 through 30 herein, Touche Ross violated, and aided and abetted the Weis Five in violating, Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, which require broker-dealers such as Weis to file with regulatory authorities accurate and truthful reports of their financial condition, including reports such as those certified by Touche Ross, in order to ensure the integrity and safety of the nation's securities markets and of the brokers and dealers that participate therein.

34. Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the class of persons which Section 17 of the 1934 Act was designed to protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934 Act. The injuries which have occurred to Weis, its creditors, customers, lenders and shareholders as a result of the liquidation of Weis were of the type that Section 17 of the 1934 Act was intended to prevent.

35. As a result of Touche Ross' violation of Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, its aiding and abetting of the Weis

Five's violation of Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, and its breach of the duties imposed by Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, Weis, its creditors, customers, lenders and shareholders have suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Second Cause Of Action

36. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 34 herein as though here set forth in full.

37. As a result of Touche Ross' negligence per se in violating Section 17 of the 1934 Act (15 U.S.C. Section 78q), and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Third Cause Of Action

38. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

39. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Fourth Cause Of Action

40. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

41. The auditing and accounting services performed by Touche Ross with respect to Weis were performed in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete.

42. By reason of the foregoing reckless and grossly negligent conduct of Touche Ross, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Fifth Cause Of Action

43. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

44. In connection with the auditing and accounting services performed by Touche Ross and as compensation therefor, Weis paid Touche Ross a certain sum of money (the "Touche Ross Fee"), the amount of which is not presently known to Plaintiff Trustee.

45. By reason of Touche Ross' breach of and failure to perform its agreement to render said auditing and accounting services in a thorough, proper, skillful and diligent manner, Weis is entitled to general damages in the amount of the Touche Ross Fee and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Sixth Cause Of Action

46. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

47. In its engagement letter with Weis and other communications to Weis, Touche Ross expressly and impliedly warranted to Weis that its services to Weis would be of a certain quality (i.e. that, *inter alia*, they would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC).

48. By reason of the breaches and failures of Touche Ross, including those set forth in paragraphs 28 through 30 herein, those services were not of the warranted quality and were wholly without value to Weis.

49. By reason of Touche Ross' breach of warranty of the quality of its services to Weis, Weis is entitled to general damages in the amount of the difference between the actual and warranted values of the services rendered, and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff SIPC's First Cause Of Action

50. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

51. Touche Ross' audit of Weis failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules and regulations promulgated thereunder, in that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements prepared by Touche Ross were false, inaccurate and incomplete.

52. As a consequence of the liquidation of Weis, the SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

53. As a result of Touche Ross' failure to comply with the auditing standards prescribed by the 1934 Act and the rules and regulations promulgated thereunder, and as a result of Touche Ross' breach of the duties it owed to SIPC thereunder, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Second Cause Of Action

54. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

55. As a result of Touche Ross' failure to comply with the auditing standards prescribed by the 1934 Act and the rules and regulations promulgated thereunder, in that the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements prepared by Touche Ross were false, inaccurate and incomplete, Touche Ross breached the duties it owed to the customers and certain other creditors of Weis by misleading them into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

56. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 55, and to pay for certain administrative expenses of the liquidation.

57. But for Touche Ross' breach of the duties it owed to the customers and certain other creditors of Weis by its failure to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules and regulations promulgated thereunder, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

58. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Third Cause Of Action

59. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

60. Touche Ross had knowledge of or, but for its errors and omissions, should have had knowledge of the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements.

61. Touche Ross breached the duties it owed to SIPC by failing to inquire as to, and to disclose, the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements.

62. The SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

63. As a result of Touche Ross' aiding and abetting of the Weis Five's violation of the 1934 Act and the rules and regulations promulgated thereunder as discussed in paragraphs 60 and 61 hereinabove, and as a result of the consequent depletion of the SIPC fund as indicated in paragraph 62 hereinabove, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Fourth Cause Of Action

64. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

65. Touche Ross had knowledge of or, but for its errors and omissions, should have had knowledge of the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements.

66. Touche Ross breached the duties it owed to the customers and certain other creditors of Weis by failing to inquire as to, and to disclose, the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements.

67. The SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

68. But for Touche Ross' aiding and abetting of the Weis Five's violation of the 1934 Act and the rules and regulations promulgated thereunder, as discussed in paragraphs 65 and 66 hereinabove, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

69. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Fifth Cause Of Action

70. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

71. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

72. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein, and not as a result of any negligence of SIPC, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Sixth Cause Of Action

73. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

74. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein (and not as a result of any negligence of any customer or creditor of Weis), the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

75. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 74, and to pay for certain administrative expenses of the liquidation.

76. But for Touche Ross' negligence and malpractice, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to these claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

77. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As and For Plaintiff SIPC's Seventh Cause of Action

78. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

79. As a consequence of the liquidation of Weis, the SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

80. As a result of the malpractice of Touche Ross and its breach of the duties it owed to SIPC (and not as a result of any negligence of SIPC), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Eighth Cause Of Action

81. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

82. As a result of the malpractice of Touche Ross and its breach of the duties it owed to the customers and certain other creditors of Weis (and not as a result of any negligence of any customer or creditor of Weis), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial

difficulty, and consequently over 34,000 of said customers and certain other creditors ultimately filed claims in the Weis liquidation proceeding.

83. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 82, and to pay for certain administrative expenses of the liquidation.

84. But for Touche Ross' malpractice, recklessness and gross negligence, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

85. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

Wherefore, plaintiffs demand judgment:

a. for $51,000,000 on Plaintiff Trustee's First Cause of Action;

b. for $51,000,000 on Plaintiff Trustee's Second Cause of Action;

c. for $51,000,000 on Plaintiff Trustee's Third Cause of Action;

d. for $51,000,000 on Plaintiff Trustee's Fourth Cause of Action;

e. for the amount of the Touche Ross Fee plus $51,000,000 on Plaintiff Trustee's Fifth Cause of Action;

f. for an amount which is the difference between the actual and warranted values of Touche Ross' services with respect to Weis, plus $51,000,000, on Plaintiff Trustee's Sixth Cause of Action;

g. for $14,000,000 on Plaintiff SIPC's First Cause of Action;

h. for $14,000,000 on Plaintiff SIPC's Second Cause of Action;

i. for $14,000,000 on Plaintiff SIPC's Third Cause of Action;

j. for $14,000,000 on Plaintiff SIPC's Fourth Cause of Action;

k. for $14,000,000 on Plaintiff SIPC's Fifth Cause of Action;

l. for $14,000,000 on Plaintiff SIPC's Sixth Cause of Action;

m. for $14,000,000 on Plaintiff SIPC's Seventh Cause of Action;

n. for $14,000,000 on Plaintiff SIPC's Eighth Cause of Action;

o. for interest on the amounts demanded herein;

p. for the costs and disbursements of this action; and

q. for such other, further and different relief as to the Court may seem just and proper.

Dated: New York, New York
April 30, 1976

HUGHES HUBBARD & REED

By /s/ JOHN S. ALLEE
A Member of the Firm
Attorneys for Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc.
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HAWKINS, DELAFIELD & WOOD

By /s/ CLARENCE FRIED
A Member of the Firm
Attorneys for Securities Investor Protection Corporation
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New York, New York 10005
(212) 952-4700

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Exhibit A to Complaint

WEIS, VOISIN & CO., INC.

REPORT ON EXAMINATION OF STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

TOUCHE ROSS & CO.

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.

REPORT ON EXAMINATION OF STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 7, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the accompanying statement of financial condition of Weis, Voisin & Co., Inc. as of May 26, 1972. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statement of financial condition referred to above presents fairly the financial position of Weis, Voisin & Co., Inc. at May 26, 1972, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.

STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

ASSETS

Cash	$ 1,758,766
Deposits with clearing organizations and others	753,033
Receivables from brokers and dealers	8,775,852
Receivables from customers	76,376,206
Secured demand notes of subordinated lenders (collateralized by securities, at quoted market $6,625,570)	4,226,794
Miscellaneous receivables	3,610,935
Securities in firm trading and investment accounts:	
Marketable securities, at quoted market	3,542,457
Securities not readily marketable, at fair value	949,908
Securities held under subordination agreements, at quoted market	5,460,751
Investment in and advances to subsidiaries, at cost, plus equity in undistributed earnings	1,153,583
Exchange memberships:	
Owned, at cost (last sales prices $1,044,606)	1,289,938
Held under subordination agreement, at last sales prices	421,494
Leasehold improvements, office furniture and fixtures, at cost, less accumulated amortization and depreciation of $789,960	3,048,296
Excess of investment over net assets acquired, less accumulated amortization of $76,465 (Note 1)	2,217,403
Miscellaneous other assets	1,983,371
	$115,568,787

See notes to statement of financial condition

WEIS, VOISIN & CO., INC.

STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans, collateralized by customers' margin accounts securities		$ 47,575,000
Short-term bank loans, collateralized by securities owned by the Company or covered by subordination agreements		6,912,245
Payables to brokers and dealers		14,311,794
Payables to customers, including $6,791,886 of fee credit balances		16,770,379
Securities sold but not yet purchased, at quoted market		2,967,457
Accounts payable and accrued expenses		2,731,488
Due to lessors on lease contracts capitalized		1,475,215
Subordinated liabilities and stockholders' equity:		
Liabilities subordinated to all claims of general creditors (Note 2)	$15,237,951	
Stockholders' equity:		
Capital stock (Note 2)	2,374,800	
Additional paid-in capital	2,767,078	
Retained earnings	3,811,397	
	8,953,275	
Less treasury stock, at cost	1,366,017	
	7,587,258	22,825,209
Contingencies and commitments (Note 3)		
		$115,568,787

WEIS, VOISIN & CO., INC.

NOTES TO

STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

NOTE 1:

As of October 1, 1971, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hockstein & Trotta, Inc., a member firm of the New York Stock Exchange. This acquisition has been accounted for as a purchase and the excess of investment over net assets acquired is being amortized over a twenty-year period.

NOTE 2:

The capital stock of the Company is composed of the following classes of stock:

Description	Number of shares: Authorized	Issued	Outstanding	In treasury	Amount
Common, par value $1, Class A (voting)	150,000	150,000	110,948	39,052	$ 150,000
Common, par value $1, Class B (non-voting)	150,000	150,000	149,080	920	150,000
Preferred, par value $100, Class A	55,000	16,248	10,273	5,975	1,624,800
Preferred, par value $100, Class B, 1% cumulative, convertible	3,500	3,500	3,500	—	350,000
Preferred, par value $100, Class C, 1% cumulative, convertible	2,500	1,000	1,000	—	100,000
Preferred, par value $100, Class D, 6% cumulative	10,000	—	—	—	—
					$2,374,800

The Company has granted stock options to subordinated lenders to purchase Class B, non-voting common stock as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date	2% of total stockholders' equity at exercise date	1976
10,907 shares	$25 per share	1975
2,000 shares	$35,000	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

NOTE 3:

Aggregate rental commitments at May 26, 1972, under material noncancelable leases for premises were approximately $34,650,000 payable as follows:

Fiscal year ending	Amount
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978-1991	20,475,000

Exhibit B to Complaint

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

AND ADDITIONAL INFORMATION

MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

AND ADDITIONAL INFORMATION

MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE AND ADDITIONAL INFORMATION MAY 26, 1972

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NOTE: In accordance with general instructions regarding the preparation of this questionnaire, questions and subdivisions have been omitted where the respondent had nothing to report.

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 7, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the answers to the financial questionnaire of Weis, Voisin & Co., Inc. as of May 26, 1972. Our examination was made in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof for the period since the prior examination date and such other auditing procedures as we considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission.

In our opinion, the accompanying answers to the financial questionnaire present fairly the financial position of Weis, Voisin & Co., Inc. at May 26, 1972, in the form prescribed by the New York Stock Exchange and the Securities and Exchange Commission, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
1. Bank balances and other deposits:						
Cash on Hand	$ 11,935					
Cash on deposit:						
Subject to immediate withdrawal	1,482,856					
Segregated under the Commodity Exchange Act	263,975					
Guaranty deposits with clearing organizations:						
General funds	599,143			$ 445,960		
Segregated under the Commodity Exchange Act	25,010					
Good faith deposits—brokers and dealers—Current	128,880					
2. Money borrowed, and accounts carried for respondent by other banking or brokerage houses, secured by or containing customers' collateral:						
A. Money borrowed:						
1. From banks, trust companies and other financial institutions		$47,575,000		71,372,501		
B. Accounts carried by other banking or brokerage houses:						
1. Securities accounts:						
a. Accounts with net debit balance, National Clearing Corp.	453,361		$1,257,102	889,204		
b. Accounts with net credit balance, Pacific Coast Stock Exchange Clearing Corp.		197,272	193,123	314,089		
2. Commodities accounts—futures:						
a. Regulated commodities accounts:						
ii. Accounts liquidating to a deficit	176,914				$15,374	$49,214
b. Non-regulated commodities accounts:						
ii. Accounts liquidating to a Deficit	44,022				16,140	30,839
3. Money borrowed, and accounts carried for respondent by other banking or brokerage houses, unsecured, or secured entirely by collateral owned by respondent and/or its officers and directors, or by securities covered by "satisfactory subordination agreements":						
A. Money borrowed:						
1. From banks, trust companies and other financial institutions		6,912,245		12,806,501		

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
4. Other accounts and open items with brokers and dealers:						
A. Securities borrowed	$2,641,600		$2,590,700			
B. Securities failed to deliver:						
1. Outstanding less than 30 days	5,051,188		4,995,527			
2. Outstanding 30 days or more:						
30 through 39 calendar days	97,518		91,758			
40 through 49 calendar days	25,311		19,721			
50 through 59 calendar days	5,932		4,600			
60 calendar days or more	66,921		79,830			
C. Securities loaned:						
1. For customers		$8,158,872		$ 8,083,063		
2. For accounts reportable under 10, 11 and 12		344,928		350,387		
D. Securities failed to receive:						
1. For customers:						
a. Outstanding less than 30 days		4,870,326		4,963,022		
b. Outstanding 30 days or more		222,859		251,152		
3. For accounts reportable under 10, 11 and 12:						
a. Outstanding less than 30 days		405,333		422,999		
b. Outstanding 30 days or more		6,071		5,516		
E. Open transactions in foreign securities with other brokers	213,085	57,594	708,348	1,502,139		
5. Valuation of securities in box, transfer and transit:						
A. Negotiable securities in box and in transfer				37,949,184		

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
6. Customers' securities accounts:						
A. Cash accounts:						
1. Accounts with debit balances	$ 4,201,268		$ 5,734,085	$ 346,799		
2. Accounts with credit balances		$5,263,785	1,616,717	5,656,274		
B. Secured Accounts:						
1. Accounts with debit balances	71,823,113		96,673,766	1,719,750		
2. Accounts with credit balances		3,207,453	562,761	3,240,069		
C. Partly secured accounts (see Reserve—Question 13):						
2. Accounts with credit balances		196		2,660		
D. Unsecured accounts (see Reserve—Question 13)	419,241			35,274		
E. Accounts with credit balances having open contractual commitments		760,916	101,005			
F. Accounts with free credit balances		6,791,886				
G. Fully paid securities not segregated:						
1. Segregation instructions issued:						
a. Securities failed to receive			1,021,791			
b. Securities due from customers			4,293,950			
c. Pending execution of instructions (based on tests, substantially all cleared within three business days)			8,704,928			
2. Substantially all in process of sale (based on tests)			7,730,105			
7. Customers' commodities accounts:						
A. Accounts with open future contracts liquidating to an equity:						
1. Regulated commodities		269,566			$36,216	$23,281
2. Non-regulated commodities		275,749			34,608	36,058
D. Unsecured debit balances	6,170					
E. Accounts with free credit balances:						
1. Regulated		143,613				
2. Non-regulated		46,871				

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
8. Accounts of officers and directors:						
A. Officers:						
1. Securities accounts:						
A. Bona fide cash accounts:						
1. Accounts with debit balances	$ 13,689		$ 14,600			
B. Secured accounts:						
1. Accounts with debit balances	101,240		117,326			
F. Accounts with free credit balances		$ 10,344				
G. Fully paid securities not segregated			11,400			
10. Trading and investment accounts of respondents:						
A. Securities accounts:						
1. Exempt securities	3,255,793	1,707,061	506,000			
2. Other securities			2,749,793	$1,707,061		
C. Arbitrage account	1,236,572	1,260,396	1,236,572	1,260,396		

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
11. Capital accounts:						
C. Corporation capital:						
1. Capital stock:						
A. Authorized:						
Class A, $1 par—150,000 shares						
Class B, $1 par—150,000 shares						
Preferred A, $100 par—55,000 shares						
Preferred B, $100 par, 1% cumulative, convertible—3,500 shares						
Preferred C, $100 par, 1% cumulative, convertible—2,500 shares						
Preferred D, $100 par, 6% cumulative—10,000 shares						
B. Issued:						
Class A, $1 par—150,000 shares		$ 150,000				
Class B, $1 par—150,000 shares		150,000				
Preferred A, $100 par—16,248 shares		1,624,800				
Preferred B, $100 par, 1% cumulative, convertible—3,500 shares		350,000				
Preferred C, $100 par, 1% cumulative, convertible—1,000 shares		100,000				
C. Treasury stock:						
Class A, $1 par—39,052 shares	$ 750,071					
Class B, $1 par—920 shares	18,400					
Preferred A, $100 par—5,975.46 shares	597,546					
2. Paid-in capital		2,767,078				
3. Retained earnings		3,811,397				

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
12. Subordinated accounts and borrowings:						
A. Subordinated accounts:						
Officer and directors:						
1. Accounts with debit balances	$ 39,939		$ 82,148			
2. Accounts with credit balances		$ 478,856	698,662			
3. Securities not readily marketable			96,157			
Debenture holders:						
1. Accounts with debit balances	14,998		116,062			
2. Accounts with credit balances		4	8,670			
Customers:						
1. Accounts with debit balances	690,260		1,431,460			
2. Accounts with credit balances		2,256,768	3,005,725			
3. Securities not readily marketable			21,867			
B. Other subordinated borrowings:						
Subordinated exchange memberships at market		421,494				
Subordinated debentures		3,110,275				
Secured demand notes—see Question 13		4,255,000				

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
13. Other accounts:						
Exchange memberships:						
Owned by respondent—at cost	$1,289,938					
Owned by stockholders (subordinated)—at last sales prices	421,494					
Leasehold improvements, office furniture and fixtures—at cost, less accumulated amortization and depreciation of $188,916	1,341,057					
Commodity difference accounts:						
Regulated		$ 19,473			$19,473	
Non-regulated		17,581			17,581	
Loans and advances	99,458					
Commissions receivable—last five trade dates	432,107					
Insurance claim receivable re Winslow, Cohu & Stetson, Inc.	1,285,401					
Investment in and advances to subsidiaries—at equity	1,153,583					
Receivable from stockholders	768,199					
Miscellaneous receivables:						
Current	503,058					
Other	108,471					
Prepaid expenses and deposits	551,138					
Deferred charges	395,901					
Dividends and interest receivable, payable and unclaimed:						
Current (outstanding less than 30 days)	48,991	120,373	$ 635,277	$591,771		
Not current	135,067	97,729	233,431	92,607		
Scheinman, Hochstin & Trotta, Inc. liquidating omnibus account	745,238					
Secured demand notes receivable from subordinated lenders, collateralized by:	4,255,000					
Cash		28,206				
Exempt securities			1,871,420			
Non-exempt securities			4,754,150			
Due from member firm	91,123					
Excess of investment over net assets acquired, less accumulated amortization of $76,465	2,217,403					
Accrued customers' interest receivable—current	139,060					

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance Debit	Ledger balance Credit	Security valuation Long	Security valuation Short	Commodity contracts Losses	Commodity contracts Gains
13. Other accounts (continued):						
Purchased public relations contracts re acquisition of Thomas J. Deegan & Co., Inc., less accumulated amortization of $29,432	$ 291,094					
Leasehold improvements, office furniture and fixtures—at cost acquired under lease contracts, less accumulated amortization and depreciation of $601,044	1,707,239					
Due to lessors on lease contracts capitalized		$ 1,475,215				
Other liabilities		946,245				
Reserve for doubtful accounts		200,000				
Accrued interest payable		275,562				
Accrued salaries and commissions		652,583				
Floor brokerage payable		74,778				
Federal, state, and local taxes payable on income		564,218				
Unlocated security differences			$ 43,821	$ 5,980		
	$112,435,971	$112,435,971	$154,014,358	$154,014,358	$139,392	$139,392

NOTE TO QUESTION 13:

Security count differences, discovered through physical count and verification procedures pursuant to Rule 17a-5 and 17a-13, classified by date of discovery, which remained unresolved or were bought or sold since the last examination date are as follows:

	Date of discovery	Number of securities	Security valuation Long	Security valuation Short
Unresolved differences	May 26, 1972	60	$43,821	$5,980
Securities bought or sold:			Bought	Sold
	March 24, 1972	3		$7,800
	November 26, 1971	1		160

There were 14,624 securities with positions at May 26, 1972.

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

16. Unrecorded assets, liabilities, and accountabilities:

Under 31 leases for premises in effect as of May 26, 1972, aggregate annual rentals are as follows:

Fiscal year ending	
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978—1991	20,475,000

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

NOTE

The Company has granted stock options to subordinated lenders to purchase Class B, non-voting common stock as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date	2% of total stockholders' equity at exercise date	1976
10,907 shares	$25 per share	1975
2,000 shares	$35,000	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

ADDITIONAL INFORMATION

The additional information presented in the following pages which has been taken primarily from accounting and other records of the Respondent has been subjected to the tests and other auditing procedures applied in our examination of the answers to financial questionnaire of Weis, Voisin & Co., Inc. as of May 26, 1972. In our opinion, such information is fairly presented in all material respects in relation to the answers to the financial questionnaire taken as a whole although it is not necessary for a fair presentation of financial position.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

SUMMARY

Aggregate indebtedness		$80,315,478
1/15 of aggregate indebtedness		$ 5,354,365
Net capital:		
Total credit items	$30,099,473	
Total debit items	21,867,090	
NET CAPITAL		8,232,383
Capital in excess of minimum requirements		$ 2,878,018
Ratio of indebtedness to capital		976%

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

Question number	Aggregate indebtedness	
2A1	Money borrowed, collateralized by customers' securities	$47,575,000
2B1	Credit balance in account carried by other banking or brokerage house	197,272
	Open items with brokers and dealers:	
4C1	Securities loaned—customers' securities	8,158,872
4D1	Securities failed to receive customers' securities	5,093,185
4E	Foreign securities transactions	57,594
	Customers' security accounts:	
6A2	Cash	5,263,785
6B2	Secured	3,207,453
6E	Accounts with credit balances having open contractual commitments	760,916
6F	Free credits	6,791,886
	Customers' commodity accounts:	
7A2	Equities in nonregulated commodities	277,199
7E1	Free credits—regulated	143,613
7E2	Free credits—nonregulated	46,871
8F	Securities and commodities accounts of officers and directors	10,344
13	Accrued interest payable	275,562
13	Accrued salaries and commissions	652,583
13	Floor brokerage payable	74,778
13	Dividends and interest payable	218,102
13	Federal, state and local taxes payable on income	564,218
13	Other liabilities	946,245
	Total aggregate indebtedness	$80,315,478

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

Question number	Credit items	
6C	Ledger balances in partly secured accounts	$ 196
10	Firm trading and investment accounts:	
	Securities long	3,255,793
	Credit balance	1,707,061
11	Capital stock—A	150,000
11	Capital stock—B	150,000
11	Capital stock—Preferred—A	1,624,800
11	Capital stock—Preferred—B	350,000
11	Capital stock—Preferred—C	100,000
11	Paid-in capital	2,767,078
11	Retained earnings	3,811,397
12A	Subordinated lenders' ledger balances—officers and directors	478,856
12A	Subordinated lenders' ledger balances—debenture holders	4
12A	Subordinated lenders' ledger balances—customers	2,256,768
12A	Securities in subordinated lenders' accounts	5,460,751
12B	Other subordinated borrowings —memberships	421,494
12B	Other subordinated borrowings —debentures	3,110,275
12B	Other subordinated borrowings —secured demand notes	4,255,000
13	Reserve for doubtful accounts	200,000
	Total credit items	$30,099,473

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

Question number	Debit items	
6C	Short securities in partly secured accounts	$ 2,660
6D	Debit balances in unsecured accounts	419,241
6D	Short securities in unsecured accounts	35,274
7D	Debit balances in unsecured commodities accounts	6,170
10	Firm trading and investment accounts:	
	Securities short	1,707,061
	Debit balance	3,255,793
11	Treasury stock, class A	750,071
11	Treasury stock, class B	18,400
11	Treasury stock, preferred A	597,546
12A	Subordinated lenders' ledger balances —officers and directors	39,939
12A	Subordinated lenders' ledger balances —debenture holders	14,998
12A	Subordinated lenders' ledger balances —customers	690,260
13	Exchange memberships—firm	1,289,938
13	Exchange memberships—subordinated lenders	421,494
13	Leasehold improvements, furniture and fixtures ect.	1,341,057
13	Miscellaneous receivables	108,471
13	Loans and advances	99,458
13	Insurance claims receivable re Winslow, Cohu & Stetson, Inc.	1,285,401
13	Investments in and advances to subsidiaries at equity	1,153,583

Question number	Debit items		
13	Prepaid expenses and deposits		551,138
13	Deferred charges		395,901
13	Dividends and interest receivable— noncurrent		135,067
13	Short securities receivable—dividends		92,607
13	Excess of investment over net assets acquired		2,217,403
13	Receivable from stockholders		768,199
13	Due from member firm		91,123
13	Purchased public relations contracts re acquisition of Thomas J. Deegan & Co., Inc.		291,094
13	Leasehold improvements, office furniture and fixtures, acquired under lease contracts	1,707,239	
	Less amount due to lessors	1,475,215	232,024
13	Scheinman, Hochstin & Trotta, Inc. liquidating omnibus account		745,238
13	Unlocated security differences—short		5,980
	Charges to capital:		
	"Haircuts" (Schedule 1):		
	Subordinated lenders—customers		1,170,062
	Subordinated lenders—debenture holders		36,580
	Subordinated lenders—officers and directors		295,194
	Firm accounts		1,529,962
	1½% of value of commodities		48,910
	Penalties on fails to deliver		23,793
	TOTAL DEBIT ITEMS		$21,867,090

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

SUMMARY OF CAPITAL CHARGES

	Long Security value	Capital charge %	Capital charge Amount
Subordinated accounts:			
Customers	$ 990	—	$ —
	19,500	1	195
	29,300	2	586
	206,400	5	10,320
	532,000	10	53,200
	66,500	15	9,975
	8,300	20	1,660
	21,867	100	21,867
	3,574,195	30	1,072,259
	$4,459,052		$1,170,062
Debenture holders	$ 5,600	15	$ 840
	119,132	30	35,740
	$ 124,732		36,580
Officers and directors	$ 2,475	—	—
	5,200	2	104
	27,780	3	833
	82,850	5	4,143
	10,500	10	1,050
	10,100	15	1,515
	11,800	20	2,360
	96,157	100	96,157
	630,105	30	189,032
	$ 876,967		295,194

	Long Security value	Capital charge %	Capital charge Amount
Firm accounts	$1,261,635	—	—
	66,482	2	1,330
	238,655	3	7,160
	53,461	5	2,673
	3,350	10	335
	122,950	15	18,443
	56,678	50	28,339
	949,908	100	949,908
	1,739,246	30	521,774
	$4,492,365		1,529,962
Commodities:			
Fails to deliver:			
40 through 49 days	$ 25,311	10	2,531
50 through 59 days	5,932	20	1,186
60 days or more	66,921	30	20,076
	$ 98,164		23,793
			$3,055,591

WEIS, VOISIN & CO., INC.

REPORT ON INTERNAL CONTROL

MAY 26, 1972

We have examined the financial statements of Weis, Voisin & Co., Inc. for the period ended May 26, 1972 and have issued our report thereon dated July 7, 1972. As a part of our examination, we reviewed and tested the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the Company's system of internal accounting control for the period November 26, 1971, the prior examination date, to May 26, 1972 was made for the purpose set forth in the first paragraph above, and it would not necessarily disclose all weaknesses in the system. However, such study and evaluation disclosed no conditions that we believe to be material weaknesses.

Touche Ross & Co.
Certified Public Accountants

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Exhibit C to Complaint

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED
FINANCIAL STATEMENTS

YEAR (52 WEEKS) ENDED MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED FINANCIAL STATEMENTS

YEAR (52 WEEKS) ENDED MAY 26, 1972

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 21, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the accompanying consolidated balance sheet of Weis, Voisin & Co., Inc. and subsidiaries as of May 26, 1972, and the related statements of earnings, stockholders' equity and changes in financial position for the year (52 weeks) then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Weis, Voisin & Co., Inc. and subsidiaries at May 26, 1972, the results of their operations and changes in their financial position for the year (52 weeks) then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
MAY 26, 1972

ASSETS

Cash	$ 1,842,307
Deposits with clearing organizations and others	753,033
Receivables from brokers and dealers (Note 4)	8,775,852
Receivables from customers (Note 4)	76,376,206
Secured demand notes of subordinated lenders (collateralized by cash of $28,206 and securities, at quoted market $6,625,570) (Note 5)	4,226,794
Miscellaneous receivables (Note 9)	3,763,785
Securities owned (Note 6)	4,492,365
Securities held under subordination agreements, at quoted market (Note 5)	5,460,751
Exchange memberships:	
Owned, at cost (last sales prices $1,044,606)	1,289,938
Held under subordination agreements, at last sales prices (Note 5)	421,494
Leasehold improvements, office furniture and fixtures, at cost, less accumulated amortization and depreciation of $1,008,058 (Note 7)	3,513,321
Excess of investment over net assets acquired, less accumulated amortization of $76,465 (Note 3)	2,217,403
Miscellaneous other assets (Note 3)	2,396,602
	$115,529,851

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
MAY 26, 1972

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans, collateralized by customers' margin accounts securities		$ 47,575,000
Short-term bank loans, collateralized by securities owned by the Company or covered by subordination agreements		6,912,245
Payables to brokers and dealers (Note 4)		14,311,794
Payables to customers (Note 4)		16,770,379
Securities sold but not yet purchased (Note 6)		2,967,457
Accounts payable and accrued expenses (Note 8)		2,952,582
Due to lessors on lease contracts capitalized (Note 7)		1,475,215
Subordinated liabilities and stockholders' equity:		
Liabilities subordinated to all claims of general creditors (Note 5)	$14,977,921	
Stockholders' equity (Notes 9 and 10):		
Capital stock	2,374,800	
Additional paid-in capital	2,767,078	
Retained earnings	3,811,397	
	8,953,275	
Less treasury stock, at cost	1,366,017	
	7,587,258	22,565,179
Contingencies and commitments (Notes 11 and 12)		
		$115,529,851

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS
YEAR (52 WEEKS) ENDED MAY 26, 1972

Revenues:		
Commissions:		
Customers		$19,160,975
Clearing brokers		762,745
Investment banking		5,191,186
Principal transactions (Note 6)		2,288,365
Interest		3,408,607
Fees		873,707
Other		161,718
		31,847,303
Expenses:		
Employee compensation	$15,575,609	
Commissions—clearing brokers	456,247	
Floor brokerage commissions	892,825	
Interest	3,120,501	
Office and equipment rentals	3,024,609	
Communications	2,596,221	
Other operating expenses	4,394,017	30,060,029
EARNINGS BEFORE TAXES ON INCOME		1,787,274
Taxes on income (Note 8)		765,000
NET EARNINGS		$ 1,022,274
Weighted average number of common and common equivalent shares outstanding (Note 13)		234,204
Earnings per common and common equivalent share (Note 13)		$4.36

See notes to consolidated financial statements

TOUCHE ROSS & Co.

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
YEAR (52 WEEKS) ENDED MAY 26, 1972

	Capital stock issued							
	Number of shares							
	Common		Preferred					
	Class A par $1.00	Class B par $1.00	Class A, par $100.00	Class B par $100.00	Class C par $100.00	Amount	Additional paid-in capital	Retained earnings
Balance, June 1, 1971	150,000	150,000	16,248	—	—	$1,924,800	$2,469,921	$2,789,123
Issued	—	—	—	3,500	1,000	450,000	—	—
Excess of proceeds over cost of treasury stock sold:								
Common, Class A—29,375 shares	—	—	—	—	—	—	17,827	—
Common, Class B—40,750 shares	—	—	—	—	—	—	279,330	—
Net earnings for the year (52 weeks) ended May 26, 1972	—	—	—	—	—	—	—	1,022,274
Balance, May 26, 1972	150,000	150,000	16,248	3,500	1,000	$2,374,800	$2,767,078	$3,811,397

	Capital stock in treasury			
	Number of shares			
	Common		Preferred	
	Class A, par $1.00	Class B par $1.00	Class A, par $100.00	Cost
Balance, June 1, 1971	61,375	24,124	6,412.96	$ 2,162,929
Purchased	7,052	17,546	4,962.50	835,057
Sold	(29,375)	(40,750)	(5,400.00)	(1,631,969)
Balance, May 26, 1972	39,052	920	5,975.46	$ 1,366,017

See notes to consolidated financial statements

TOUCHE ROSS & Co.

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR (52 WEEKS) ENDED MAY 26, 1972

Source of funds:	
Operations:	
Net earnings	$ 1,022,274
Non-cash charges—depreciation and amortization	538,410
	1,560,684
Increase in:	
Short-term bank loans, collateralized by customers' margin account securities	31,073,040
Short-term bank loans, collateralized by securities owned by the Company or covered by subordination agreements	5,612,245
Payable to brokers and dealers	5,062,360
Payable to customers	5,642,327
Securities sold but not yet purchased	2,833,092
Liabilities subordinated to all claims of general creditors	6,474,117
Proceeds from issue of preferred stock	450,000
Proceeds from sale of treasury stock:	
Cost	1,631,969
Excess of proceeds over cost	297,157
Other sources	61,550
	60,698,541

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

Application of funds:	
Increase in:	
Deposits with clearing organizations	487,317
Receivables from brokers and dealers	4,064,603
Receivables from customers	42,799,812
Secured demand notes of subordinated lenders	4,226,794
Miscellaneous receivables	1,397,252
Securities owned	924,121
Securities held under subordination agreements	146,933
Exchange memberships owned	154,050
Exchange memberships held under subordination agreements	152,768
Miscellaneous other assets	1,750,911
Purchase of leasehold improvements and furniture and fixtures	1,937,996
Excess of investment over net assets acquired	2,217,403
Purchase of treasury stock	835,057
	61,095,017
Decrease in cash	$ 396,476

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of Weis, Voisin & Co., Inc. and all of its subsidiaries. The results of operations of companies purchased are included from the dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation.

2. ACCOUNTING:

In 1972 the Company adopted a fiscal year consisting of the fifty-two or fifty-three week period ending the last Friday of May. Prior to 1972, the Company's fiscal year ended on May 31.

Security transactions are recorded in the accounts on settlement date. Commission income and related expenses for transactions executed but not settled are accrued on financial statement dates.

3. ACQUISITIONS:

Scheinman, Hochstin & Trotta, Inc.:

As of October 1, 1971, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hochstin & Trotta, Inc. (SH&T), a former member firm of the New York Stock Exchange. This acquisition has been accounted for as a purchase and the excess of investment over net assets acquired of

$2,293,868 is being amortized over a twenty-year period.

As part of the purchase agreement a subordinated lender of SH&T agreed to become a subordinated lender of the Company and to indemnify the Company to a maximum of $4,000,000 in the event the assumed liabilities exceeded the acquired assets. Through May 26, 1972 the liabilities assumed exceed the assets acquired by approximately $750,000 which is included in miscellaneous other assets.

Thomas J. Deegan Company, Inc.:

As of July 1, 1971, the Company acquired the outstanding capital stock of Thomas J. Deegan Company, Inc. in exchange for 3,500 shares of its 1% cumulative convertible preferred par value $100, Class B stock. The Company is accounting for this acquisition as a purchase.

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4. RECEIVABLES FROM AND PAYABLES TO BROKERS AND DEALERS AND CUSTOMERS:

The components of receivables from and payables to brokers and dealers as of May 26, 1972 are as follows:

Securities failed to deliver	$ 5,246,870
Deposits paid for securities borrowed	2,641,600
Other	887,382
Total receivables from brokers and dealers	$ 8,775,852
Securities failed to receive	$ 5,642,689
Deposits received for securities loaned	8,433,450
Other	235,655
Total payables to brokers and dealers	$14,311,794

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

Receivables from and payables to customers represent the dollar balances arising in connection with normal cash and margin transactions. The receivables are collateralized by securities held by the Company which are not reflected in the accompanying consolidated financial statements. Free credit balances totaling approximately $6,792,000 at May 26, 1972 are included in payables to customers. Accounts of officers, directors and stockholders are included in receivables from and payables to customers since they are subject to the normal terms and regulations as to payment and, in the aggregate, are not significant.

5. LIABILITIES SUBORDINATED TO ALL CLAIMS OF GENERAL CREDITORS:

Certain creditors of the Company have signed agreements subordinating their debentures, exchange memberships or securities accounts to all claims of general creditors, and thus the respective amounts are available to the Company in computing net capital under the New York Stock Exchange rule regarding capital requirements (see Note 10). These agreements generally specify release, payment, or redemption no less than six months following the date on which the lender demands termination subject to approval of the New York Stock Exchange. These liabilities at May 26, 1972 are summarized as follows:

	Rate of interest	
Debentures	7-10%	$ 3,110,275
Secured demand notes	8%	4,255,000
Exchange memberships	6-8%	421,494
Equities in securities accounts:		
Securities at quoted market	2.8-5%	5,460,751
Cash	4-10%	1,730,401
		$14,977,921

6. SECURITIES OWNED:

Securities owned at May 26, 1972 consist of the Company's regular trading and investment accounts and are summarized as follows:

		Cost
Marketable securities—at quoted market:		
U.S. Government bonds	$ 330,200	$ 332,560
Municipal bonds	175,800	162,587
Corporate debentures and note	69,718	69,608
Corporate stocks	1,730,167	1,745,421
Arbitrage (convertible within 30 days)	1,236,572	1,151,459
	3,542,457	3,461,635
Securities not readily marketable—at fair value	949,908	508,244
	$4,492,365	$3,969,879
Marketable securities sold but not yet purchased—at quoted market:		
Corporate debentures and notes	$ 24,734	$ 24,700
Corporate stocks	1,682,327	1,671,581
Arbitrage (convertible within 30 days)	1,260,396	1,192,206
	$2,967,457	$2,888,487

Quoted market has been determined by reference to available quotations as to marketable securities. The fair values of securities not readily marketable have been determined by management. Fair values as determined are, in the aggregate, not less than cost.

The increase in unrealized appreciation on securities owned for the fiscal year ended May 26, 1972 of $285,516 is included in principal transactions on the statement of earnings. The effect on net earnings (after taxes) is $170,667 or $.73 per share.

7. LEASEHOLD IMPROVEMENTS, OFFICE FURNITURE AND FIXTURES:

Leasehold improvements, office furniture and fixtures include approximately $2,300,000 of such assets acquired under lease contracts. The net book value of these assets of approximately $1,700,000 collateralizes the amounts due to lessors on lease contracts capitalized. The Company computes depreciation and amortization on the straight-line method for financial statement purposes (see Note 8).

8. TAXES ON INCOME:

Taxes on income indicate a significant variation in the customary relationship to earnings before taxes on income due to the effect of the different tax rates applied to ordinary income and capital gains, and because federal taxes on income were reduced by $113,000 of investment tax credit. The Company accounts for the investment tax credit by use of the flow-through method. Deferred

income taxes of $18,000 have been provided on the difference in depreciation and amortization for leasehold improvements, office furniture and fixtures acquired since June 1, 1971, computed by the double-declining balance method for tax purposes and the straight-line method for financial reporting purposes. The liability for taxes on income ($564,000 after reduction for estimated tax payments) at May 26, 1972 is included in accounts payable and accrued expenses.

9. STOCKHOLDERS' EQUITY:

The capital stock of the Company is composed of the following at May 26, 1972:

Description	Number of shares: Authorized	Issued	Outstanding	In treasury	Amount
Common, par value $1, Class A (voting)	150,000	150,000	110,948	39,052	$ 150,000
Common, par value $1, Class B (non-voting)	150,000	150,000	149,080	920	150,000
Preferred, par value $100, Class A	55,000	16,248	10,273	5,975	1,624,800
Preferred, par value $100, Class B, 1% cumulative, convertible	3,500	3,500	3,500	—	350,000
Preferred, par value $100, Class C, 1% cumulative, convertible	2,500	1,000	1,000	—	100,000
Preferred, par value $100, Class D, 6% cumulative	10,000	—	—	—	—
					$2,374,800

The Company has granted stock options (at option prices not less than fair market value as determined by the Company) to subordinated lenders to purchase Class B, non-voting common stock as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date	2% of total stockholders' equity at exercise date	1976
10,907 shares	$25 per share	1975
2,000 shares	$35,000	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

Subject to certain anti-dilution provisions, the 3,500 shares of Class B preferred stock are convertible, in whole but not in part, into 3,500 shares each of Class A and Class B common stock and the 1,000 shares of Class C preferred stock are convertible, in whole but not in part, into 2,000 shares of Class B common stock.

As of May 26, 1972, $768,000 included in miscellaneous receivables in the accompanying consolidated balance sheet was due from employees in connection with the purchase of the Company's capital stock.

10. NET CAPITAL REQUIREMENTS:

The Company is required to comply with a New York Stock Exchange regulation which provides that the Company maintain a ratio of aggregate indebtedness to net capital, as defined, not exceeding 15 to 1. The excess net capital as computed under this rule was approximately $2,878,000 at May 26, 1972.

11. COMMITMENTS AND CONTINGENCIES:

There are various lawsuits pending against the Company which, in the opinion of management, will be resolved with no material adverse effect on the financial condition of the Company.

Aggregate rental commitments at May 26, 1972 under material noncancellable leases for premises were approximately $34,650,000 payable as follows:

Fiscal year ending	Amount
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978-1991	20,475,000

In the normal course of business, the Company enters into underwriting commitments. Transactions relating to underwriting commitments which were open as of May 26, 1972 and subsequently settled, had no material effect on the financial statements at that date.

12. PROFIT SHARING PLAN:

The Company has a non-contributory profit sharing plan, qualified under the Internal Revenue Code, which covers substantially all employees with more than one year's service. The plan is funded through a self-administered trust and may be terminated at any time by the Company. Contributions to the Trust are made at the sole discretion of the Company's Board of Directors. The amount charged to income during the year was $150,000.

13. EARNINGS PER SHARE:

Earnings per common share and common equivalent share were computed by dividing net earnings by the weighted-average number of Class A voting and Class B non-voting common shares and common share equivalents outstanding during the year. The number of common share equivalents outstanding during the year. The number of common share equivalents outstanding included, (1) weighted-average of 6,417 shares issuable on conversion of the Class B preferred stock, (2) weighted average of 1,360 shares issuable on conversion of the Class C preferred stock and (3) 600 shares issuable on exercise of stock options which are dilutive. All other stock options outstanding are anti-dilutive and are excluded in computing earnings per share.

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Exhibit D to Complaint

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED FINANCIAL STATEMENTS

FIVE YEARS ENDED MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED FINANCIAL STATEMENTS

FIVE YEARS ENDED MAY 26, 1972

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 21, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the accompanying consolidated balance sheet of Weis, Voisin & Co., Inc. and subsidiaries as of May 26, 1972, and the related statement of earnings for the five years then ended and the related statements of stockholders' equity and changes in financial position for the three years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Weis, Voisin & Co., Inc. and subsidiaries at May 26, 1972, and the results of their operations and the changes in their financial position for the periods indicated, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

	Year ended May 31,				Year (52 weeks) ended May 26, 1972
	1968	1969	1970	1971	(Note A)
Revenues (Note B):					
Commissions (Note C):					
Customers	$10,069,939	$13,769,505	$10,834,529	$13,533,183	$19,160,975
Clearing brokers	8,077,966	9,684,578	7,887,924	3,011,337	762,745
Investment banking (Note D)	471,190	3,359,274	2,446,189	1,596,898	5,191,186
Principal transactions (Note E)	974,778	425,719	2,825,483	1,336,104	2,288,365
Interest (Note F)	2,378,745	3,532,765	4,979,995	2,748,397	3,408,607
Fees	348,755	385,860	298,150	803,270	873,707
Other	166,798	447,920	525,850	455,016	161,718
	22,488,171	31,605,621	29,298,120	23,484,205	31,847,303
Expenses:					
Employee compensation (Note G)	8,405,466	13,831,272	11,852,884	10,605,677	15,575,609
Commissions—clearing brokers	5,780,308	7,027,742	5,044,094	1,922,969	456,247
Floor brokerage commissions	1,470,879	1,539,924	1,044,958	861,370	892,825
Interest	1,128,850	1,589,146	3,112,488	2,247,205	3,120,501
Office and equipment rentals	784,998	1,423,922	1,971,289	2,074,299	3,024,609
Communications	777,153	1,219,448	2,023,393	1,842,214	2,596,221
Other operating expenses	2,113,091	4,114,189	3,624,121	3,245,782	4,394,017
	20,461,045	30,745,643	28,673,227	22,799,516	30,060,029
EARNINGS BEFORE TAXES ON INCOME	2,027,126	859,978	624,893	684,689	1,787,274
Taxes on income (Note H)	882,000	418,000	206,000	336,000	765,000
NET EARNINGS	$ 1,145,126	$ 441,978	$ 418,893	$ 348,689	$ 1,022,274
Weighted average number of common and common equivalent shares outstanding (Notes B and I)	211,429	213,136	238,605	219,114	234,204
Earnings per common and common equivalent share (Notes E, H and I)	$5.42	$2.07	$1.76	$1.59	$4.36

See notes to consolidated statement of earnings

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENT OF EARNINGS

NOTE A:

In 1972 the Company adopted a fiscal year consisting of the fifty-two or fifty-three week period ending the last Friday of May. Prior to 1972, the Company's fiscal year ended on May 31.

Security transactions are recorded in the accounts on settlement date. Commission income and related expenses for transactions executed but not settled are accrued on financial statement dates.

NOTE B:

As discussed in Note 2 to the consolidated financial statements, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hochstin & Trotta, Inc., and acquired certain selected assets of Winslow, Cohu & Stetson, Incorporated and undertook to liquidate its assets and liabilities. The statement of earnings reflects operations of these acquisitions from their respective acquisition dates. Separate statements of operations of these companies are not included because both acquisitions were of offices, registered representatives and customers together with related assets. Since processing operations and associated costs of both companies have been eliminated, presentation of past operational data and pro forma statements of operations for periods prior to acquisition would not be meaningful.

The statement of earnings reflects operations of VCL Associates, a limited partnership, all of whose assets and liabilities were transferred to the Company on May 27, 1971 (see Notes H and 2). The weighted average number of common and common equivalent shares outstanding for years prior to the date of acquisition reflect retroactively the shares issued in connection with the acquisition. Net earnings of this company prior to its acquisition have been transferred to Additional Paid-in Capital.

NOTE C:

Details of commission income are as follows:

Year ended	Listed	Over-the-counter	Mutual funds	Commodities	Total
May 31, 1968	$14,991,050	$2,884,241	$157,323	$115,291	$18,147,905
May 31, 1969	17,497,592	5,190,585	669,449	96,457	23,454,083
May 31, 1970	14,002,091	3,856,612	261,732	102,018	18,222,453
May 31, 1971	13,764,538	2,091,596	422,929	265,457	16,544,520
May 26, 1972	15,475,771	3,143,198	834,209	470,542	19,923,720

NOTE D:

Investment banking income is as follows:

Year ended	Underwriting management—manager	Syndicate member	Total
May 31, 1968	$ 185,087	$ 286,103	$ 471,190
May 31, 1969	3,002,414	356,860	3,359,274
May 31, 1970	1,598,406	847,783	2,446,189
May 31, 1971	69,236	1,527,662	1,596,898
May 26, 1972	2,334,849	2,856,337	5,191,186

NOTE E:

Securities owned and securities sold but not yet purchased are valued at quoted market or fair value resulting in unrealized appreciation/(depreciation), which is reflected in principal transactions for each period. The change in unrealized appreciation/(depreciation) as shown below is due not only to fluctuations in the quoted market or fair value of individual securities owned, but it is also affected by gains/(losses) realized on transactions in these securities during the period. For tax purposes securities owned are valued at cost. The change in unrealized appreciation/(depreciation) by year, the effect on net earnings and the related per share effect are as follows:

Year ended	Change in unrealized appreciation/(depreciation)	Increase/(decrease) in net earnings	
		Amount	Per share
May 31, 1968	$ 418,448	$ 301,348	$ 1.43
May 31, 1969	(507,843)	(365,343)	(1.71)
May 31, 1970	20,233	13,533	.06
May 31, 1971	319,474	214,074	.98
May 26, 1972	285,516	170,667	.73

NOTE F:

Interest income is derived from interest-bearing securities and deposits, and from credit extended to

customers for security purchases on margin and is as follows:

Year ended	Interest on margin accounts	Other	Total
May 31, 1968	$2,352,305	$26,440	$2,378,745
May 31, 1969	3,465,047	67,718	3,532,765
May 31, 1970	4,966,369	13,626	4,979,995
May 31, 1971	2,721,393	27,004	2,748,397
May 26, 1972	3,390,844	17,763	3,408,607

NOTE G:

The Company has a noncontributory profit-sharing plan, qualified under the Internal Revenue Code, which covers substantially all employees with more than one year's service. The plan is funded through a self-administered trust and may be terminated at any time by the Company. Contributions to the trust are made at the sole discretion of the Company's Board of Directors. The amount charged to income was $154,000 in 1968, $209,000 in 1969, none in 1970 and 1971, and $150,000 in 1972.

NOTE H:

The effective rate of taxes on income varies from year to year due primarily to the different tax rates applied to ordinary income and capital gains, investment tax credits, and the varying tax rates during the five-year period. The Company accounts for the investment tax credits, which amounted to $10,000 in 1968, $87,000 in 1969, none in 1970 and 1971, and $113,000 in 1972, by use of the flow-through method. State and local taxes included in taxes

on income were $77,000 in 1968, $18,000 in 1969, $70,000 in 1970, $52,000 in 1971 and $112,000 in 1972. As discussed in Notes B and 2, VCL Associates operated as a limited partnership. Pro forma provisions for taxes on income which would have been required had this business operated as a corporation are included in taxes on income in the following amounts: 1968—$2,900, 1969—$24,000, 1970—$207,800, and 1971—$2,200. These additional tax provisions reduced consolidated net earnings per share in 1968 by $.01, 1969—$.11, 1970—$.87, and 1971—$.01.

NOTE I:

Earnings per common and common equivalent share for each of the four years ended May 31, 1971 were computed by dividing net earnings by the weighted-average number of Class A voting and Class B non-voting common shares outstanding during the respective years since there were no dilutive common share equivalents outstanding during this period. For the year (52 weeks) ended May 26, 1972 the weighted-average number of common shares was increased by common share equivalents including (1) weighted-average of 6,417 shares issuable on conversion of the Class B preferred stock, (2) weighted-average of 1,360 shares issuable on conversion of the Class C preferred stock and (3) 600 shares issuable on exercise of stock options which are dilutive. All other stock options outstanding during this period are antidilutive and were excluded in computing earnings per share.

NOTE J:

No dividends have been paid by the Company.

TOUCHE ROSS & CO.

WEIS VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
MAY 26, 1972

ASSETS

Cash	$	1,842,307
Deposits with clearing organizations and others		753,033
Receivables from brokers and dealers (Note 3)		8,775,852
Receivables from customers (Note 3)		76,376,206
Secured demand notes of subordinated lenders (collateralized by cash of $28,206, and securities at quoted market $6,625,570) (Note 4)		4,226,794
Miscellaneous receivables (Note 9)		3,763,785
Securities owned, at quoted market or fair value (Note 5)		4,492,365
Securities held under subordination agreements, at quoted market (Note 4)		5,460,751
Exchange memberships:		
Owned—at cost (last sales prices $1,044,606)		1,289,938
Held under subordination agreements, at last sales prices (Note 4)		421,494
Leasehold improvements, office furniture and fixtures—at cost, less accumulated amortization and depreciation of $1,008,058 (Note 6)		3,513,321
Excess of investment over net assets acquired, less accumulated amortization of $76,465 (Note 2)		2,217,403
Miscellaneous other assets (Note 2)		2,396,602
		$115,529,851

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
MAY 26, 1972

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans (Note 7)			$ 54,487,245
Payables to brokers and dealers (Note 3)			14,311,794
Payables to customers (Note 3)			16,770,379
Securities sold but not yet purchased, at quoted market (Note 5)			2,967,457
Accounts payable and accrued expenses (Note 8)			2,952,582
Due to lessors on lease contracts capitalized (Note 6)			1,475,215
Subordinated liabilities and stockholders' equity:			
Liabilities subordinated to all claims of general creditors (Note 4)	$14,977,921		
Stockholders' equity (Notes 9 and 10):			
Capital stock	2,374,800		
Additional paid-in capital	2,767,078		
Retained earnings	3,811,397		
	8,953,275		
Less treasury stock—at cost	1,366,017		
	7,587,258		22,565,179
Contingencies and commitments (Note 11)			
			$115,529,851

WEIS, VOISIN & CO., INC.

AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Capital stock issued							
	Number of shares							
	Common		Preferred					
	Class A par $1.00	Class B par $1.00	Class A par $100.00	Class B par $100.00	Class C par $100.00	Amount	Additional paid-in capital	Retained earnings
Balance June 1, 1969—as previously reported	144,700	150,000	14,961	—	—	$1,790,812	$ 967,778	$2,331,404
Adjustment to reflect acquisition of VCL Associates (Notes 2 and B)	—	—	—	—	—	—	(142,659)	—
Balance June 1, 1969—as adjusted	144,700	150,000	14,961	—	—	1,790,812	825,119	2,331,404
Issued	5,300	—	1,287	—	—	133,988	127,450	—
Excess of proceeds over cost of treasury stock sold:								
Common Class A 17,075 shares	—	—	—	—	—	—	344,755	—
Common Class B 40,626 shares	—	—	—	—	—	—	628,025	—
Net earnings for the year ended May 31, 1970 (Note B)	—	—	—	—	—	—	305,142	113,751
Pro forma taxes on income (Note H)	—	—	—	—	—	—	207,800	—
Balance May 31, 1970	150,000	150,000	16,248	—	—	1,924,800	2,438,291	2,445,155
Excess of proceeds over cost of treasury stock sold—common Class A 9,750 shares	—	—	—	—	—	—	82,581	—
Excess of cost over proceeds of treasury stock sold—common Class B 14,250 shares	—	—	—	—	—	—	(57,872)	—
Net earnings for the year ended May 31, 1971 (Note B)	—	—	—	—	—	—	4,721	343,968
Pro forma taxes on income (Note H)	—	—	—	—	—	—	2,200	—
Balance May 31, 1971	150,000	150,000	16,248	—	—	1,924,800	2,469,921	2,789,123
Issued	—	—	—	3,500	1,000	450,000	—	—
Excess of proceeds over cost of treasury stock sold:								
Common Class A 29,375 shares	—	—	—	—	—	—	17,827	—
Common Class B 40,750 shares	—	—	—	—	—	—	279,330	—
Net earnings for the year ended May 26, 1972	—	—	—	—	—	—	—	1,022,274
Baiance May 26, 1972	150,000	150,000	16,248	3,500	1,000	$2,374,800	$2,767,078	$3,811,397

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Capital stock in treasury			
	Number of shares			
	Common		Preferred	
	Class A par $1.00	Class B par $1.00	Class A par $100.00	Cost
Balance June 1, 1969 —as previously reported	47,950	41,250	4,157	$ 1,211,341
Adjustment to reflect shares issued in connection with acquisition of VCL Associates (Notes 2 and B)	—	(12,000)	—	(260,000)
Balance June 1, 1969 —as adjusted	47,950	29,250	4,157	951,341
Purchased	19,000	21,750	9,297	1,802,184
Sold	(17,075)	(40,626)	(6,945)	(1,153,493)
Balance May 31, 1970	49,875	10,374	6,509	1,600,032
Purchased	21,250	28,000	1,191	1,037,814
Sold	(9,750)	(14,250)	(1,286)	(474,917)
Balance May 31, 1971	61,375	24,124	6,414	2,162,929
Purchased	7,052	17,546	4,961	835,057
Sold	(29,375)	(40,750)	(5,400)	(1,631,969)
Balance May 26, 1972	39,052	920	5,975	$ 1,366,017

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
SOURCE OF FUNDS:			
Operations:			
Net earnings exclusive of earnings applicable to VCL Associates credited to additional paid-in capital	$ 113,751	$ 343,968	$ 1,022,274
Noncash charges—depreciation and amortization	266,497	426,422	538,410
	380,248	770,390	1,560,684
Decrease in:			
Deposits with clearing organizations and others	238,940	—	—
Receivables from brokers and dealers	7,320,413	446,876	—
Receivables from customers	5,709,490	13,543,056	—
Miscellaneous receivables	—	1,263,919	—
Securities held under subordination agreements	—	752,398	—
Exchange memberships:			
Owned	—	190,000	—
Held under subordination agreements	801,828	—	—

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
Increase in:			
Short-term bank loans, collateralized by customers' margin account securities	18,737,500	—	31,073,040
Short-term bank loans, collateralized by securities owned by the company or covered by subordination agreements	—	1,300,000	5,612,245
Payables to brokers and dealers	—	3,392,640	5,062,360
Payables to customers	—	—	5,642,327
Securities sold but not yet purchased	217,361	—	2,833,092
Accounts payable and accrued expenses	—	837,782	—
Due to lessors on lease contracts capitalized.	487,763	320,424	—
Liabilities subordinated to all claims of general creditors	933,576	352,089	6,474,117
Proceeds from the issue of:			
Common stock	132,750	—	—
Preferred stock	128,688	—	450,000
Proceeds from sale of treasury stock:			
Cost	1,153,493	474,917	1,631,969
Excess of proceeds over cost	972,780	24,709	297,157

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
Equity of VCL Associates acquired as of May 27, 1971	—	637,204	—
Other sources	—	—	61,550
	37,214,830	24,306,404	60,698,541

–10–

Page 2

APPLICATION OF FUNDS:			
Increase in:			
Deposits with clearing organizations and others	$ —	$ 154,286	$ 487,317
Receivables from brokers and dealers	—	—	4,064,603
Receivables from customers	—	—	42,799,812
Secured demand notes of subordinated lenders	—	—	4,226,794
Miscellaneous receivables	2,816,756	—	1,397,252
Securities owned	44,199	1,413,137	924,121
Securities held under subordination agreements	1,174,127	—	146,933
Exchange memberships:			
Owned	696,000	—	154,050
Held under subordination agreements	—	64,754	152,768

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
Miscellaneous other assets	543,416	39,862	1,750,911
Decrease in:			
Short-term bank loans, collateralized by customers' margin account securities	—	14,535,540	—
Payables to brokers and dealers	20,486,933	—	—
Payables to customers	7,985,597	5,695,133	—
Securities sold but not yet purchased	—	662,445	—
Accounts payable and accrued expenses	298,020	—	—
Purchase of leasehold improvements, furniture and fixtures	606,969	1,400,183	1,937,996
Purchase of treasury stock	1,802,184	1,037,814	835,057
Excess of investment over net assets acquired	—	—	2,217,403
	36,454,201	25,003,154	61,095,017
INCREASE/(DECREASE) IN CASH	$ 760,629	$ (696,750)	$ (396,476)

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of Weis, Voisin & Co., Inc. and all of its subsidiaries. The results of operations of companies purchased are included from the dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation. The parent company accounts for its investments in subsidiaries by the equity method.

2. ACQUISITIONS:

Scheinman, Hochstin & Trotta, Inc.:

As of October 1, 1971, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hochstin & Trotta, Inc. (SH&T), a former member firm of the New York Stock Exchange. This acquisition has been accounted for as a purchase and the excess of investment over net assets acquired of $2,293,868 is being amortized over a twenty-year period.

As part of the purchase agreement a subordinated lender of SH&T agreed to become a subordinated lender of the Company and to indemnify the Company to a maximum of $4,000,000 in the event the assumed liabilities exceeded the acquired assets. Through May 26, 1972 the liabilities assumed exceed the assets acquired by approximately $750,000 which is included in miscellaneous other assets.

Thomas J. Deegan Company, Inc.:

As of July 1, 1971, the Company acquired the outstanding capital stock of Thomas J. Deegan Company, Inc. in exchange for 3,500 shares of its 1% cumulative convertible preferred par value $100, Class B stock. The Company is accounting for this acquisition as a purchase.

VCL Associates:

As of May 27, 1971, the business and all of the assets and liabilities of VCL Associates, a limited partnership, were transferred to the Company in exchange for 12,000 shares of Class B common stock. Prior to the transfer, the Company and VCL Associates were "under common control" and the accounting for the transaction is similar to that used in a pooling of interests. The number of common shares outstanding for years prior to the date of acquisition reflect retroactively the shares issued in connection with the acquisition.

Winslow, Cohu & Stetson, Incorporated:

As of September 29, 1969, the Company acquired certain selected assets of a former New York Stock Exchange member firm, Winslow, Cohu & Stetson, Incorporated (WCS) and undertook to liquidate its assets and liabilities. This acquisition has been accounted for as a purchase. WCS assets realized and liabilities liquidated through May 26, 1972 have resulted in a net deficiency of approximately $411,000 which, in accordance with the purchase agreement, has been charged in the financial statements against the subordinated accounts ($4,315,402 at May 26, 1972) transferred from WCS. In the event that the assets realized and liabilities liquidated result ultimately in a net surplus, the Company will issue a 20-year subordinated debenture to the former stockholders of WCS in an amount equal to the net surplus.

3. RECEIVABLES FROM AND PAYABLES TO BROKERS DEALERS AND CUSTOMERS:

The components of receivables from and payables to brokers and dealers as of May 26, 1972 are as follows:

Securities failed to deliver:	
Outstanding less than 30 days	$ 5,051,188
Outstanding 30 days or more	195,682
Deposits paid for securities borrowed	2,641,600
Other	887,382
Total receivables from brokers and dealers	$ 8,775,852
Securities failed to receive:	
Outstanding less than 30 days	$ 5,386,021
Outstanding 30 days or more	256,668
Deposits received for securities losses	8,433,450
Other	235,655
Total payables to brokers and dealers	$14,311,794

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

Receivables from and payables to customers represent the dollar balances arising in connection with normal cash and margin transactions. The receivables are collateralized by securities with a quoted market of $100,306,000 held by the Company which are not reflected in the accompanying consolidated financial statements. Free credit balances totaling approximately $6,792,000 at May 26, 1972 are included in payables to customers. Accounts of officers, directors and stockholders are included in receivables from and payables to customers since they are subject to the normal terms and regulations as to payment and, in the aggregate, are not significant.

4. LIABILITIES SUBORDINATED TO ALL CLAIMS OF GENERAL CREDITORS:

Certain creditors of the Company have signed agreements subordinating their debentures, exchange memberships or securities accounts to all claims of general creditors, and thus the respective amounts are available to the Company in computing net capital under the New York Stock Exchange rule regarding capital requirements (see Note 11). These agreements generally specify release, payment, or redemption no less than six months following the date on which the lender demands termination subject to approval of the New York Stock Exchange. These liabilities at May 26, 1972 are summarized as follows:

	Rate of interest	
Debentures	7 - 10%	$ 3,110,275
Secured demand notes	8%	4,255,000
Exchange memberships	6 - 8%	421,494
Equities in securities accounts:		
Securities at quoted market	2.8 - 5%	5,460,751
Cash	4 - 10%	1,730,401
		$14,977,921

5. SECURITIES OWNED:

Securities owned at May 26, 1972 consist of the Company's regular trading and investment accounts and are summarized as follows:

		Cost
Marketable securities—at quoted market:		
U.S. Government bonds	$ 330,200	$ 332,560
Municipal bonds	175,800	162,587
Corporate debentures and notes	69,718	69,608
Corporate stocks	1,730,167	1,745,421
Arbitrage (convertible within 30 days)	1,236,572	1,151,459
	3,542,457	3,461,635
Securities not readily marketable—at fair value	949,908	508,244
	$4,492,365	$3,969,879
Marketable securities sold but not yet purchased—at quoted market:		
Corporate debentures and notes	$ 24,734	$ 24,700
Corporate stocks	1,682,327	1,671,581
Arbitrage (convertible within 30 days)	1,260,396	1,192,206
	$2,967,457	$2,888,487

Quoted market has been determined by reference to available quotations as to marketable securities. The fair values of securities not readily marketable have been determined by management. Fair values as determined are, in the aggregate, not less than cost.

The following securities included above have quoted market or fair values which exceed 5% of the balance sheet caption:

	Quoted market or fair value	Cost
Marketable securities:		
Alaska Interstate convertible debenture 6%, February 1, 1996	$404,421	$408,236
Harmony Gold Mining Ltd.	240,663	212,596
Security National Bank of Long Island	327,500	430,000
Securities not readily marketable—		
Electro-Catheter	234,983	48,330
Securities sold but not yet purchased:		
Alaska Interstate	396,250	435,239
Channel Companies, Inc.	948,500	948,500
Harmony Gold Mining Ltd. ADR	259,125	215,437
Medallion Leisure Corp.	346,000	346,000

6. LEASEHOLD IMPROVEMENTS, OFFICE FURNITURE AND FIXTURES:

Leasehold improvements, office furniture and fixtures include approximately $2,300,000 of such assets acquired under lease contracts. The net book value of these assets of approximately $1,700,000 collateralizes the amounts due to lessors on lease contracts capitalized. The Company computes depreciation and amortization by the straight-line method for financial statement purposes (see Note 8).

Maintenance and repairs are charged to expense as incurred. Renewals and betterments are capitalized. The cost of assets retired or otherwise disposed of is removed from the asset accounts and the related reserve for depreciation is removed from the reserve account; any resulting gain or loss is included in income.

7. SHORT-TERM BANK LOANS:

The Company borrows from banks primarily to finance customers' purchases on margin and dealer inventory positions. At May 26, 1972, bank borrowings of $6,912,245 were collateralized by securities owned by the Company or covered by subordination agreements having a quoted market of $12,807,000 and borrowings of $47,575,000 were collateralized by securities owned by customers having a quoted market of $71,373,000. The customer-owned securities pledged are those securities for which the Company has the right of hypothecation under signed margin agreements.

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES:

Included in accounts payable and accrued expenses are the following:

Accrued salaries and commissions	$653,000
Federal, state and local taxes on income	564,000
Interest payable on short term-bank loans and subordinated borrowings	280,000
Unclaimed dividends and interest items	218,000

Deferred income taxes of $18,000 have been provided on the difference in depreciation and amortization for leasehold improvements, office furniture and fixtures acquired since June 1, 1971, computed by the double-declining balance method for tax purposes and the straight-line method for financial reporting purposes.

9. STOCKHOLDERS' EQUITY:

The capital stock of the Company is composed of the following at May 26, 1972:

	Number of shares				
Description	Authorized	Issued	Outstanding	In treasury	Amount
Common, par value $1, Class A (voting)	150,000	150,000	110,948	39,052	$ 150,000
Common, par value $1, Class B (non-voting)	150,000	150,000	149,080	920	150,000
Preferred, par value $100, Class A	55,000	16,248	10,273	5,975	1,624,800
Preferred, par value $100, Class B, 1% cumulative, convertible	3,500	3,500	3,500	—	350,000
Preferred, par value $100, Class C, 1% cumulative, convertible	2,500	1,000	1,000	—	100,000
Preferred, par value $100, Class D, 6% cumulative	10,000	—	—	—	—
					$2,374,800

The Company has granted stock options (at opiton prices not less than fair market value as determined by the Company) to subordinated lenders to purchase Class B, nonvoting common stock which are currently exercisable as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date (5,200 shares at May 26, 1972)	2% of total stockholders' equity at exercise date ($29.18 per share, $151,745 total at May 26, 1972	1976
10,907 shares	$25 per share; $272,675 total	1975
2,000 shares	$17.50 per share; $35,000 total	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

Subject to certain antidilution provisions, the 3,500 shares of Class B preferred stock are convertible, in whole but not in part, into 3,500 shares each of Class A and Class B common stock and the 1,000 shares of Class C preferred stock are convertible, in whole but not in part, into 2,000 shares of Class B common stock. An increase of 150,000 shares in the number of Class A and Class B common shares authorized was approved by the stockholders in June 1972.

As of May 26, 1972, $768,000 included in miscellaneous receivables in the accompanying consolidated balance sheet was due from employees in connection with the purchase of the Company's capital stock.

10. NET CAPITAL REQUIREMENTS:

The Company is required to comply with a New York Stock Exchange regulation which provides that the Company maintain a ratio of aggregate indebtedness to net capital, as defined, not exceeding 15 to 1. The excess net capital as computed under this rule was approximately $2,878,000 at May 26, 1972.

11. COMMITMENTS AND CONTINGENCIES:

There are various lawsuits pending against the Company which, in the opinion of management, will be resolved with no material adverse effect on the financial condition of the Company.

Aggregate rental commitments at May 26, 1972 under material noncancellable leases for premises were approximately $34,650,000 payable as follows:

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Fiscal year Ending	Amount
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978-1991	20,475,000

In the normal course of business, the Company enters into underwriting commitments. Transactions relating to underwriting commitments which were open as of May 26, 1972 and subsequently settled, had no material effect on the financial statements at that date.

Defendant's Notice of Motion to Dismiss

Filed September 22, 1976

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

PLEASE TAKE NOTICE that, upon the annexed affidavits of Arnold I. Roth (sworn to September 15, 1976), Philip H. Cohen (sworn to September 14, 1976) and Barry N. Cooper (sworn to September 14, 1976), and the complaint and the prior proceedings herein, the undersigned will move this Court, before the Honorable Inzer B. Wyatt, in Room 905, United States Court House, Foley Square, New York, New York on October 1, 1976, at 2:30 P.M., or as soon thereafter as counsel can be heard, for an order

1. Pursuant to Rule 12(b), F.R.Civ.P., dismissing this action, said complaint, and each so-called cause of action therein alleged, on the grounds that this Court lacks subject matter jurisdiction and plaintiffs have failed to state a claim upon which relief can be granted; and,

2. To the extent that the foregoing relief is not granted, staying this action pending determination of the action in the Supreme Court of the State of New York, New York County, entitled *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76); and

3. Granting to defendant such other relief as is just and proper.

September 15, 1976

ROSENMAN COLIN FREUND
LEWIS & COHEN

By /s/ ARNOLD I. ROTH
A Partner
Attorneys for Defendant
575 Madison Avenue
New York, New York 10022
212-644-7000

TO:

HUGHES HUBBARD & REED
Attorneys for Plaintiff
Edward S. Redington
One Wall Street
New York, New York 10005

HAWKINS, DELAFIELD & WOOD
Attorneys for Plaintiff
Securities Investor
Protection Corporation
67 Wall Street
New York, New York 10005

Affidavit of Arnold I. Roth in Support of Motion to Dismiss

Filed September 22, 1976

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

ARNOLD I. ROTH, being duly sworn, deposes and says:

1. I am a member of the firm of Rosenman Colin Freund Lewis & Cohen, attorneys for defendant Touche Ross & Co. ("Touche Ross") herein. I submit this Affidavit together with the accompanying Affidavits of Philip H. Cohen and Barry N. Cooper, in support of the present motion by defendant Touche Ross for an order (i) pursuant to Rule 12(b), F.R.Civ.P., dismissing the complaint herein, each of the so-called "causes of action" therein alleged, and this action, on the grounds of lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, and (ii) to the extent that the foregoing relief is not granted, staying this action pending determination of the action in the Supreme Court of the State of New York, New York County, entitled *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investors Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76) (the "State Court Action").

2. This is yet another in the series of actions in this Court which arise from the liquidation under the Securities Investor Protection Act of 1970 ("SIPA") of the defunct brokerage firm, Weis Securities, Inc. ("Weis"), and which would impose liability upon defendant Touche Ross, a

firm of certified public accountants, by reason of its work on certain financial statements of Weis for periods ending approximately a year before the Weis collapse. This action is brought by plaintiffs Edward S. Redington ("Redington"), the Trustee for the liquidation of Weis, and Securities Investor Protection Corporation ("SIPC"), and seeks from defendant Touche Ross aggregate alleged damages of over $65,000,000.

3. Although plaintiffs seek to create the appearance of federally-created claims primarily by the now familiar tactic of alleging that the conduct of defendant Touche Ross of which they complain violated the Securities Exchange Act of 1934 (the "1934 Act"), they are here asserting what are essentially state-created, common law claims of negligence, malpractice, breach of contract and breach of warranty. Indeed, so clear is the basic common law nature of plaintiff's claims, even to plaintiffs themselves, that they did not even commence this action until almost a year after they had commenced a separate action (the "State Court Action") in the New York State courts seeking, on the basis of identical factual allegations and almost identical claims as are now asserted in the complaint in this action, the same relief against defendant Touche Ross as they now seek here.

4. The accompanying memorandum sets forth in detail the reasons which compel the granting of the present motion and the dismissal of the complaint and each of the "causes of action" therein alleged. This affidavit (and the accompanying Cohen and Cooper Affidavits) sets forth facts concerning this action and the State Court Action, and pertinent to an understanding of the many reasons why this action must be dismissed, and why plaintiffs are and should be limited to proceeding with their claims, if in fact they have any viable claims, in the State Court Action.

5. This action was commenced on April 30, 1976, by the filing of the complaint herein. A copy of the complaint is annexed hereto as Exhibit 1.

6. Almost ten months prior to the commencement of this action, by service of a summons on July 3, 1975, plaintiffs herein commenced the State Court Action in the Supreme Court of the State of New York, County of New York, under the title (which is the same as the title of this action) *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76). Copies of the summons, and the subsequently served complaint, in the State Court Action are annexed hereto as, respectively, Exhibits 2 and 3.

The parties to the State Court Action are the same as the parties to this action and the complaint in the State Court Action asserts identical factual allegations and almost identical claims, and seeks identical relief, as does the complaint in this action.

7. Defendant Touche Ross has commenced discovery in the State Court Action, having served extensive interrogatories therein on both plaintiff Redington and plaintiff SIPC and notices to take the deposition of each. Objections and answers to the interrogatories were originally due on, respectively, September 13 and September 20, and the depositions were originally set to commence on September 27 for plaintiff SIPC and on September 30 for plaintiff Redington. At plaintiffs' request, each of those dates has been adjourned for approximately one month.

8. The extensive litigation in this Court arising out of the collapse of Weis involves matters and facts pertinent to this action, among which are those set forth below.

9. The complaint herein refers (¶ 14) to the "SEC . . . action in this Court (73 Civ. 2332) against Weis and

the Weis Five for injunctive relief" an action which led to plaintiff Redington's appointment as Trustee. The complaint of the Securities and Exchange Commission (the "SEC") in that action, a copy of which is annexed hereto as Exhibit 4, alleged violations of the securities acts in connection with Weis' allegedly false financial statements *only against Weis itself and certain of its officers.* Even after the "separate investigations by the Exchange and the SEC" referred to in the complaint herein (¶ 13), the SEC complaint *did not allege that defendant Touche Ross had committed or participated in or aided and abetted any such violations.* A necessary conclusion is that the "investigations" by the SEC and the Exchange revealed that defendant Touche Ross had not committed or been involved in any violations.

10. Moreover, in the indictment filed in this Court against several former Weis officers in *United States* v. *Arthur Levine et al.* (73 Crim. 693), a copy of which is annexed hereto as Exhibit 5, Count I significantly alleged that those officers

> *"did fraudulently conceal from Weis' auditors, Touche Ross & Co., the existence and nature of the aforesaid fraudulent books and records* and, in addition, . . . *did create* directly and indirectly *wholly fictitious documentation for the aforesaid fraudulent entries"* (emphasis added) (Exh. 5, p. 5),

and three of those officers, including the former Chairman of the Board and Chief Executive Officer, the President and the Comptroller, have admitted the truth of such allegations by pleading guilty to Count I of the indictment (see copy of criminal docket sheet annexed hereto as Exhibit 6).

11. There are presently in this Court a number of actions against defendant Touche Ross which arise out of

the Weis situation. Various decisions have been rendered in those actions, and are referred to in the accompanying memorandum as pertinent.

12. In one of those actions, which was brought as a purported class action on behalf of the *customers* of Weis during the relevant period, Judge Brieant recognized that the claims against defendant Touche Ross by reason of its involvement with Weis—claims which were the same as those of plaintiffs Redington and SIPC here (indeed, claims which plaintiff SIPC purports to assert here as an alleged subrogee)—were not claims under the 1934 Act, but were at most non-federal, common law claims for negligence and malpractice which should be determined by the State courts. *Rich* v. *Touche Ross & Co.*, CCH Fed. Sec. L. Rep. ¶95,514 (S.D.N.Y. 1976). Judge Brieant held that the Rich plaintiffs did not state a claim for relief under the 1934 Act, and dismissed their second amended complaint, a copy of which is annexed hereto as Exhibit 7. Thereafter, the plaintiffs in *Rich* v. *Touche Ross & Co.*, as have other customers, commenced a State court action which is brought as a purported class action, and which is now pending in the Supreme Court of the State of New York, County of New York.

13. Another related group of such actions are the three actions in this court entitled, respectively, *Sheldon Berger et al.* v. *Weis Securities, Inc., et al.* (74 Civ. 186 (I.B.W.)), *George P. Govatos, Sr.* v. *Weis Securities, Inc., et al.* (74 Civ. 2832 (I.B.W.)) and *Irwin S. Barshack* v. *Weis Securities, Inc., et al.* (74 Civ. 2833 (I.B.W.)). Copies of the second amended complaint in the *Berger* action, and the amended complaint in the *Govatos* and *Barshack* action, are annexed hereto as, respectively, Exhibits 8 and 9.

On June 27, 1975, Judge Wyatt rendered an unreported decision on a motion by defendant Touche Ross to

dismiss the second amended complaint and amended complaint. In that decision, a copy of which is annexed hereto as Exhibit 10, Judge Wyatt granted the motion with respect to claims made under Section 17(a) of the 1934 Act (claims which were similar to those asserted in this action by plaintiffs Redington and SIPC).

14. This action involves claims based upon Section 17 of the 1934 Act and Rule 17a-5 thereunder. Because Section 17 and Rule 17a-5 have been substantially amended since the time in 1972 pertinent to this action, copies of Section 17 and Rule 17a-5 in effect at that time are annexed hereto as, respectively, Exhibits 11 and 12, for the convenience of the Court.

15. For the reasons set forth in the accompanying memorandum it is respectfully submitted that the present motion of defendant Touche Ross be granted.

/s/ ARNOLD I. ROTH

Arnold I. Roth

[Jurat omitted in printing]

Exhibit 1 to Affidavit of Arnold I. Roth:
Complaint in this Action

Exhibit 1 to the affidavit of Arnold I. Roth is the complaint and the exhibits thereto. The complaint and the exhibits thereto are printed in this appendix at pp. 5-111, *supra*.

Exhibit 2 to Affidavit of Arnold I. Roth:
Summons in State Court Action

Served July 3, 1975

SUPREME COURT OF THE
STATE OF NEW YORK
COUNTY OF NEW YORK

EDWARD S. REDINGTON, As Trustee for the Liquidation of the Business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.,

Defendant.

INDEX NO.

Plaintiffs designate New York County as the place of Trial

SUMMONS WITH NOTICE

Plaintiff Edward S. Redington, Trustee, resides at One Wall Street, New York, New York 10005.

Plaintiff Securities Investor Protection Corporation ("SIPC") resides at 900 Seventeenth Street, N. W., Washington, D. C. 20006.

To the above named Defendant:

YOU ARE HEREBY SUMMONED to appear in this action by serving a notice of appearance on the plaintiffs' attorneys within 20 days after the service of this summons, exclusive of the day of service.

Take notice that the object of this action is to recover damages for negligence, malpractice, fraud, breach of

contract and breach of warranty in connection with auditing and accounting services rendered by defendant to Weis Securities, Inc., and in case of your failure to appear, judgment will be taken against you by default for the sum of $55,000,000.00 on behalf of plaintiff Edward S. Redington, Trustee, and for the sum of $14,500,000.00 on behalf of plaintiff SIPC, plus interest from July 7, 1972 and the costs and disbursements of this action.

The basis of the venue designated is the residence of the defendant, which is 1633 Broadway, New York, New York 10019.

Dated: July 2, 1975

HUGHES HUBBARD & REED
Attorneys for Trustee
One Wall Street
New York, New York 10005
(212) 943-6500

WILFRED R. CARON, ESQ.
Attorney for SIPC
c/o Goldman & Drazen
One State Street Plaza
New York, New York 10004
(212) 422-0488

Exhibit 3 to Affidavit of Arnold I. Roth:
Complaint in State Court Action
Served May 3, 1976

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.,

Defendant.

COMPLAINT

Index No.

Plaintiffs, EDWARD S. REDINGTON, Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, by their respective attorneys, complaining of the Defendant, allege upon information and belief, except as to paragraphs 1, 2, 4, 9, 10 and 17 hereof, as follows:

PARTIES

1. Plaintiff Edward S. Redington (the "Trustee") was duly appointed by Order of the United States District Court for the Southern District of New York dated May 30, 1973 as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis") pursuant to the Securities

Investor Protection Act of 1970 (15 U.S.C. Section 78aaa, *et seq.*) (hereinafter the "1970 Act"), has duly qualified, and is presently acting in such capacity.

2. Plaintiff Securities Investor Protection Corporation ("SIPC") is a non-profit membership corporation created by and organized under the 1970 Act whose members are, with certain statutory exceptions, all persons registered as broker-dealers under the Securities Exchange Act of 1934 (15 U.S.C. Section 78a, *et seq.*) (hereinafter the "1934 Act") and, with certain statutory exceptions, all persons who are members of a national securities exchange. The duties and functions of SIPC are set forth in the 1970 Act and include, *inter alia*, the initiation of liquidation proceedings against members of SIPC that have failed or are in danger of failing to meet their obligations to customers, the establishment of a fund from which to satisfy, within certain limits, the claims of customers of SIPC members that are being liquidated pursuant to the 1970 Act, and—in consultation with and with the cooperation of the Securities and Exchange Commission ("SEC"), the New York Stock Exchange, Inc. (the "Exchange") and other self-regulatory organizations—the establishment of procedures designed to detect approaching financial difficulty of SIPC members and to ensure that such members are in compliance with applicable financial responsibility rules. SIPC relies entirely and solely on the SEC, the Exchange and other self-regulatory organizations to monitor the financial condition of SIPC members, to investigate any SIPC member in financial difficulty, and to notify SIPC thereof. At all relevant times Weis was a member of SIPC.

3. Defendant Touche Ross & Co. ("Touche Ross") is a partnership of certified public accountants with its principal place of business at 1633 Broadway in the City,

County and State of New York. In or about 1969, Touche Ross was engaged by Weis as its independent certified public accounting firm, and Touche Ross continued to act in such capacity from about 1969 until about May 1973, when the forced liquidation of Weis commenced.

COMMON ALLEGATIONS

4. At all relevant times prior to May 30, 1973, Weis was a corporation registered as a broker-dealer with the SEC and was engaged in the business of a broker-dealer of securities. From June 1965 until May 1973, Weis was a member of the Exchange, the self-regulatory organization designated by SIPC to examine Weis for compliance with the applicable financial responsibility rules imposed on broker-dealers pursuant to Section 6 of the 1934 Act (15 U.S.C. Section 78f) for the protection of the public as a minimum prerequisite for conducting a business as a broker-dealer in securities.

5. For each of its four fiscal years 1968 through 1971 (ended May 31), Weis' audited financial statements reflected a profit. During early 1972 five of Weis' officers (the "Weis Five") became increasingly concerned that a fair and accurate presentation of Weis' results of operations for fiscal year 1972 would reflect that Weis was operating at a loss. The Weis Five misstated the financial condition and results of operations of Weis in financial reports prepared at fiscal year-end 1972. These reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders. Such misstatements were accomplished by, *inter alia*, materially overstating assets, creating non-existent assets, understating liabilities, overstating income, and under-

stating expenses. The purpose and effect of such material misstatements were, *inter alia,* to create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000 before taxes whereas in truth and in fact Weis had actually suffered losses in that period in excess of $1,500,000.

6. Had Weis' actual financial condition, its actual results of operations, and the misstatement in its books and records been truthfully reported at the end of Weis' 1972 fiscal year, Weis' 1973 forced liquidation under the 1970 Act would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved by a number of means including, *inter alia,* change in Weis' management, reversal of its policy of growth and expansion, curtailment or contraction of certain of its operations and business practices, gradual liquidation of some or all of its operations, or merger with another securities firm. Moreover, if a liquidation of Weis had been necessary as the result of such truthful reporting, such liquidation could have occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later.

7. The incorrect and incomplete fiscal 1972 year-end reports prepared by and under the direction of the Weis Five were certified by Touche Ross as being correct and complete. Consequently, the doctoring of Weis' books, records and required reports, the deterioration of its financial condition and the violations of financial responsibility rules could not be nipped in the bud at a time when a forced liquidation of Weis could still have been avoided. Instead, during Weis' fiscal year 1973, Weis' financial condition deteriorated as the Weis policy of expansion continued unabated. Weis incurred substantial operating losses, depletion of its assets, and depletion of the property

held by Weis in trust for its customers. The Weis Five continued to make false and fictitious entries in Weis' books and records and continued, directly or indirectly, to submit false reports to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders in order to conceal Weis' true financial condition.

8. Not until April and May of 1973, as a result of separate investigations by the Exchange and the SEC, did the misstatement of Weis' financial condition come to light. These investigations gradually revealed the violations of financial responsibility rules, Weis' unsafe, unsatisfactory and deteriorating financial condition, and the lack of accuracy and reliability of any of its financial statements, including those certified by Touche Ross. These revelations and the resulting uncertainties with respect to Weis' true financial condition prevented Weis from being saved as a going concern or being merged with another, financially more secure, brokerage firm, and resulted in Weis' forced liquidation under the 1970 Act.

9. On May 24, 1973, in the United States District Court for the Southern District of New York, the SEC commenced an action against Weis and the Weis Five for injunctive relief to prevent them from conducting a brokerage business in violation of the 1934 Act and the rules and regulations promulgated thereunder. Also on May 24, 1973 (the "Filing Date"), pursuant to Section 5(a)(2) of the 1970 Act (15 U.S.C. Section 78eee(a)(2)), SIPC applied in the same Court for a decree adjudicating that the customers of Weis were in need of the protection of the 1970 Act. On May 30, 1973 (the "Date of Adjudication") such a decree was granted, the liquidation of Weis was ordered, and Plaintiff Edward S. Redington was appointed Trustee for the liquidation of the business of Weis.

10. Upon the entry of the decree referred to in the preceding paragraph, SIPC was required by the 1970 Act to provide, and did provide to the Trustee, funds for the payment of claims submitted by certain customers and creditors of Weis and for certain administrative expenses of the liquidation.

11. At all relevant times, Defendant Touche Ross held itself out to Weis, the SEC, SIPC, the Exchange and the general public as possessing the ordinary skill, ability and expertise of certified public accountants in accounting and auditing matters, and as being qualified, *inter alia,* (i) to examine and audit the books, records and accounts of firms engaged in the securities business in accordance with generally accepted auditing standards and (ii) to express opinions with respect to the financial statements of such firms as fairly reflecting their financial condition and results of operations in accordance with generally accepted accounting principles. Touche Ross further held itself out as being familiar with accounting and auditing practices and standards required by the SEC and the Exchange for firms engaged in the securities business.

12. From approximately 1969 until the Date of Adjudication, Touche Ross was engaged by Weis for valuable consideration to serve as Weis' independent certified public accounting firm. During this period Touche Ross agreed to conduct annual audits of the affairs of Weis and to issue opinions and prepare reports on its financial statements, all in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the SEC and the Exchange. In accepting said engagement, Touche Ross agreed to perform said services in a thorough, proper, skillful and diligent manner.

13. Weis and its Board of Directors, customers, creditors, lenders and shareholders, and the SEC, the

Exchange and SIPC relied on Touche Ross to apply the standards and expertise to express the opinions, to make the certifications and to prepare or assist in the preparation of the reports discussed in paragraphs 11 and 12, *supra,* for the purposes, among others, of (i) protecting Weis from fraudulent activity of its officers, directors, agents, and employees; (ii) safeguarding the existence and use of Weis' assets; (iii) assuring the accuracy of financial data submitted directly or indirectly to the Exchange, the SEC and SIPC, and generally made available to the public; (iv) determining whether Weis could continue to engage in business as a broker-dealer in securities; (v) determining whether or not significant restrictions and alterations in the scope and nature of its operations would be required in order for Weis to continue to engage in business as a broker-dealer; and (vi) making informed business decisions concerning the future operations of Weis on the basis of accurate financial information.

14. In or about late 1971 or early 1972, Touche Ross agreed with Weis to perform the aforementioned auditing and accounting services for the year 1972. Among other things, Touche Ross agreed (a) to prepare, cause to be prepared, and assist in the preparation of financial statements of Weis and to issue opinion letters with respect to said statements; (b) to audit the affairs of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations promulgated by the Exchange and the SEC pursuant to Sections 6 and 17 of the 1934 Act (15 U.S.C. Sections 78f and 78q); (c) to notify the Exchange promptly that such audit had been commenced; (d) to prepare an answer to the financial questionnaire (the "Answers to the Financial Questionnaire") of the Exchange based upon said audit; (e) to submit to the

Exchange (i) a copy of the Answers to the Financial Questionnaire, (ii) an attestation that the requirements of the audit regulations had been observed in the conduct of the audit, and (iii) a statement that Touche Ross had made a review of Weis' accounting system, internal accounting control and procedures for safeguarding securities; (f) to furnish to the Exchange comments relative to any material inadequacies found to exist in Weis' accounting system, internal accounting control, and procedures for safeguarding securities; and (g) to indicate any corrective action taken or proposed.

15. Weis' employment of Touche Ross as its independent certified public accounting firm was not merely a matter of private contract between Weis and Touche Ross, but was required by the Exchange pursuant to its duty under Section 6 of the 1934 Act (15 U.S.C. Section 78f) to regulate its members' conduct of their businesses and supervise their financial condition for the benefit of the public. Touche Ross knew or should have known that Weis' engagement of an independent certified public accounting firm was a requirement of the Exchange and that it was for the benefit both of Weis in making decisions with respect to the operation of its business and of persons other than Weis.

16. In accordance with its engagement agreement, Touche Ross purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972 and in connection therewith (a) certified, prepared, caused to be prepared, and assisted in the preparation of financial statements of Weis; (b) prepared and certified Weis' Answers to the Financial Questionnaire; and (c) issued four opinion letters (the "1972 Opinion Letters") to the Board of Directors of Weis dated, respectively, July 7, 1972, July 7, 1972, July 21, 1972 and July 21, 1972.

17. By means of the foregoing, Touche Ross represented and certified that it had examined (i) the statement of Weis' financial condition as of May 26, 1972, (ii) Weis' Answers to the Financial Questionnaire as of May 26, 1972, (iii) Weis' consolidated balance sheet for the 52 weeks ended May 26, 1972, and (iv) Weis' consolidated statement of earnings for the five years ended May 26, 1972. The letter pertaining to the Answers to the Financial Questionnaire stated that the Touche Ross examination had been made "in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof . . . as [Touche Ross] considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission." The letter also stated that the Answers to the Financial Questionnaire presented fairly the financial position of Weis at May 26, 1972 in the form prescribed by the Exchange and the SEC in conformity with generally accepted accounting principles applied on a consistent basis. Each of the other three 1972 Opinion Letters stated that the Touche Ross examination had been conducted in accordance with generally accepted auditing standards and that the aforementioned financial statements presented fairly the financial position of Weis and subsidiaries at May 26, 1972, and the results of operations and changes in their financial position for the year and the five years then ended in conformity with generally accepted accounting principles applied on a consistent basis. (The 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements are annexed hereto as Exhibits A, B, C and D.)

18. Touche Ross knew, should have known and intended that Weis and its Board of Directors would rely

on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements for various purposes, including those set forth in paragraph 13, *supra*.

19. Touche Ross knew, should have known and intended that the SEC, the Exchange and SIPC would rely on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in carrying out their respective regulatory, supervisory and protective duties with respect to Weis, in determining whether Weis was in compliance with the applicable financial responsibility rules, and in determining whether Weis was in financial difficulty.

20. Touche Ross knew, should have known and intended that Weis' customers, creditors, lenders and shareholders would rely directly or indirectly on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in making decisions whether to commence or continue their respective relationships with Weis.

21. Touche Ross breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner in that, among other things, it:

a. failed to audit, verify and examine the books, records, accounts and financial statements of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC;

b. failed to prepare, cause to be prepared, and assist in the preparation of accurate financial statements of Weis and Weis' Answers to the Financial Questionnaire;

c. rendered the 1972 Opinion Letters, which were false, inaccurate and incomplete;

d. failed properly to test, study and evaluate Weis' system of internal accounting control;

e. failed to obtain competent evidential matter sufficient to afford a proper basis for the 1972 Opinion Letters;

f. falsely certified that it had examined Weis' books and records in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC; and

g. failed to inform or otherwise alert Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC) (i) of the material errors in Weis' Answers to the Financial Questionnaire and in Weis' financial statements prepared in connection with the 1972 Touche Ross audit; (ii) of the existence of inaccurate and unreliable books and records with respect to Weis; or (iii) of the possibility that Weis was facing financial difficulty.

22. Specifically, among other things, Touche Ross failed properly to audit, verify and examine:

(a) the Scheinman Hochstin & Trotta liquidation omnibus account (the "SH&T Omnibus Account"), a claimed asset of $745,000. If Touche Ross had audited, verified and examined the SH&T Omnibus Account in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that in or about April 1972 the SH&T Omnibus Account had been debited in the amount of approximately $625,000;

(2) that, contrary to generally accepted accounting principles, the offsetting credits for this debit were to one or more income accounts;

(3) that the purpose and effect of these improper credits were to overstate Weis' gross income by approximately $625,000 and its net income and net worth by approximately $312,500; and

(4) that an overstatement by this amount was a material overstatement because it constituted over 30% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and over 4% of Weis' claimed net worth as of that date.

(b) the Winslow, Cohu & Stetson ("WC&S") insurance claim receivable, a claimed asset of $1,285,000. If Touche Ross had audited, verified and examined the WC&S insurance claim receivable in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that, on or about May 8, 1972, the WC&S insurance claim receivable had improperly been increased in value (debited) to $785,000 because of interest purportedly payable on the claim;

(2) that, on or about May 25, 1972, the WC&S insurance claim receivable had improperly been further increased in value (debited) to $1,285,000 because of a purported increase in the value of the claim;

(3) that, contrary to generally accepted accounting principles, the offsetting credits for these two debits had been made to various income accounts;

(4) that the purpose and effect of these improper transactions were to overstate Weis' gross income by approximately $685,000 and its net income and net worth by approximately $342,500;

(5) that an overstatement by this amount was a material overstatement because it constituted nearly 35% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and approximately 4.5% of Weis' claimed net worth as of that date.

(c) other false, fraudulent and improper entries, irregularities and accounting transactions in the books of Weis which included, *inter alia,* the following:

(1) The re-depositing into income accounts of at least $800,000 worth of checks which were purportedly drawn to pay vendors or other creditors, thus overstating Weis' net income and net worth by at least $400,000;

(2) The doubling (to approximately $432,000) of accrued commission income for May 22-26, 1972, thus overstating Weis' net income, net worth, and net capital by approximately $108,000;

(3) The improper crediting of income accounts with proceeds from a sale-leaseback transaction, thus overstating Weis' net income and net worth;

(4) The improper transfer of certain short security positions to dividend receivable accounts;

(5) The improper failure to record certain liabilities of Weis on the books of Weis;

(6) The manipulation of certain error accounts to reflect false credit balances of $100,000 to $200,000, which then were taken into income, thus overstating Weis' net income, net worth and net capital by approximately $50,000 to $100,000;

(7) The improper designation of up to $500,000 worth of miscellaneous receivables as "current" so that it was not necessary to deduct them from capital in computing Weis' net capital ratio under Exchange Rule 325, with the result that Weis' net capital ratio was made to appear to be below 10:1 and Weis thus was not precluded by Exchange Rule 326 from expanding its business.

23. Upon the discovery by Touche Ross of any one or more of the false entries or improper accounting transactions discussed in paragraph 22 above, Touche Ross would have had an obligation to report such discoveries, *inter alia,* to Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC); and it would have had an obligation to report such discoveries in the 1972 Opinion Letters and to refrain from issuing the 1972 Opinion Letters in the form they actually took.

24. As a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC:

a. the acts of the Weis Five as set forth in paragraphs 5 through 8 herein were not promptly discovered, and the Weis Five were able to continue to make false and fictitious entries in Weis' books, records and financial statements;

b. other misstatements and inaccuracies in Weis' books, records and financial statements were not discovered;

c. Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and

shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules;

d. Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from (i) knowing the true financial condition of Weis, (ii) performing their respective duties to safeguard the assets of Weis and the property Weis was holding in trust for its customers, (iii) taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis under the 1970 Act could have been prevented, and (iv) taking or causing to be taken appropriate and immediate action to avoid or reduce the costs of satisfying the claims of Weis' customers;

e. the acts of the Weis Five as set forth in paragraphs 5 through 8 herein were not discovered by Weis, its Board of Directors, the SEC, SIPC or the Exchange until April and May 1973 at which time the only remedial action that could be taken was the forced liquidation of Weis under the 1970 Act, which caused and continues to cause substantial injury to Weis and SIPC as well as Weis' customers, creditors, lenders and shareholders;

f. the assets of Weis and the property Weis was holding in trust for its customers were not on the Filing Date or thereafter sufficient to satisfy the claims of Weis' customers, creditors, lenders and shareholders;

g. Weis was unable to comply with the minimum financial responsibility rules which would allow it to conduct its business as a broker-dealer in securities, was unable to restore itself to a condition in which it could remain in business, and lost the value of its business and assets as a going concern;

h. the assets of Weis were wasted and mismanaged; and

i. Weis was caused to undertake financial obligations which it could not satisfy and which it would not or could not have undertaken had its true financial condition as of May 26, 1972 been known to Weis and its Board of Directors, the SEC, the Exchange and SIPC.

As and For Plaintiff Trustee's First Cause of Action

25. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

26. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 21 through 23 herein, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As and For Plaintiff Trustee's Second Cause of Action

27. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

28. Touche Ross violated and aided and abetted the Weis Five's violation of a statute (Section 17 of the 1934 Act (15 U.S.C. Section 78q)), the purpose of which was to protect a class of persons that included Weis, its customers, creditors, lenders and shareholders from the types of injuries that they respectively and collectively have suffered on account of the forced liquidation of Weis.

29. As a result of Touche Ross' negligence per se, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff Trustee's Third Cause of Action

30. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

31. The auditing and accounting services performed by Touche Ross with respect to Weis were performed in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete.

32. By reason of the foregoing reckless and grossly negligent conduct of Touche Ross, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff Trustee's Fourth Cause of Action

33. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

34. In connection with the auditing and accounting services performed by Touche Ross and as compensation therefor Weis paid Touche Ross a certain sum of money (the "Touche Ross Fee"), the amount of which is not presently known to Plaintiff Trustee.

35. By reason of Touche Ross' breach of and failure to perform its agreement to render said auditing and accounting services in a thorough, proper, skillful and diligent manner, as set forth in paragraphs 21 through 23 herein, Weis is entitled to general damages in the amount of the Touche Ross Fee and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff Trustee's Fifth Cause of Action

36. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

37. In its engagement letter with Weis and other communications to Weis, Touche Ross expressly and impliedly warranted to Weis that its services to Weis would be of a certain quality (i.e. that, *inter alia,* they would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC).

38. By reason of the breaches and failures of Touche Ross, including those set forth in paragraphs 21 through 23 herein, those services were not of the warranted quality and were wholly without value to Weis.

39. By reason of Touche Ross' breach of warranty of the quality of its services to Weis, Weis is entitled to general damages in the amount of the difference between the actual and warranted values of the services rendered, and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff SIPC's First Cause of Action

40. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

41. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

42. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 21 through 23 herein, and not as a result of any negligence of SIPC, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As and for Plaintiff SIPC's Second Cause of Action

43. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

44. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

45. As a result of the malpractice of Touche Ross and its breach of the duties it owed to SIPC (and not as a result of any negligence of SIPC), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were

false, inaccurate and incomplete, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As and for Plaintiff SIPC's Third Cause of Action

46. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

47. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 21 through 23 herein, and not as a result of any negligence of any customer or creditor of Weis, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

48. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and creditors of Weis, hereinabove mentioned in paragraph 47, and to pay for certain administrative expenses of the liquidation.

49. But for Touche Ross' negligence and malpractice, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services it performed with respect to Weis.

50. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As and for Plaintiff SIPC's Fourth Cause of Action

51. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

52. As a result of the malpractice of Touche Ross and its breach of the duties it owed to the customers and certain other creditors of Weis (and not as a result of any negligence of any customer or creditor of Weis), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

53. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and creditors of Weis, hereinabove mentioned in paragraph 52, and to pay for certain administrative expenses of the liquidation.

54. But for Touche Ross' malpractice, recklessness and gross negligence, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to any and all claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services it performed with respect to Weis.

55. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

WHEREFORE, plaintiffs demand judgment:

a. for $51,000,000 on Plaintiff Trustee's First Cause of Action;

b. for $51,000,000 on Plaintiff Trustee's Second Cause of Action;

c. for $51,000,000 on Plaintiff Trustee's Third Cause of Action;

d. for the amount of the Touche Ross Fee plus $51,000,000 on Plaintiff Trustee's Fourth Cause of Action;

e. for an amount which is the difference between the actual and warranted values of Touche Ross' services with respect to Weis, plus $51,000,000, on Plaintiff Trustee's Fifth Cause of Action;

f. for $14,000,000 on Plaintiff SIPC's First Cause of Action;

g. for $14,000,000 on Plaintiff SIPC's Second Cause of Action;

h. for $14,000,000 on Plaintiff SIPC's Third Cause of Action;

i. for $14,000,000 on Plaintiff SIPC's Fourth Cause of Action;

j. for interest on the amounts demanded herein;

k. for the costs and disbursements of this action; and

l. for such other, further and different relief as to the Court may seem just and proper.

Dated: New York, New York
May 3, 1976

HUGHES HUBBARD & REED
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[Exhibits A, B, C and D to the Complaint in the State Court Action are the same as Exhibits A, B, C and D to the Complaint in this action, which are printed in this appendix at pp. 35-111, *supra.*]

[Exhibit 4 through Exhibit 12 to the Affidavit of Arnold I. Roth omitted in printing]

Affidavit of Wilfred R. Caron in Opposition to Motion to Dismiss

Filed January 10, 1977

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

District of Columbia: ss.

WILFRED R. CARON, being duly sworn, deposes and says:

1. Deponent is the Associate General Counsel of plaintiff Securities Investor Protection Corporation ("SIPC") and is familiar with the prior proceedings herein, in particular the motion of the defendant Touche Ross & Co. ("Touche Ross") pursuant to Rule 12 of the Federal Rules of Civil Procedure to dismiss SIPC's complaint for alleged legal insufficiency and jurisdictional reasons. This affidavit is respectfully submitted in opposition to that motion.

2. Deponent is informed by SIPC's attorneys of record that Touche Ross' engagements in proceedings under the Securities Investor Protection Act of 1970 ("SIPA") may be relevant to certain aspects of Touche Ross' aforesaid motion, particularly insofar as those engagements indicate Touche Ross' awareness of its obligations to SIPC and of SIPC's structure, functions and objectives. The purpose of this affidavit, therefore, is to set forth certain general information relating to that subject.

3. To date, pursuant to section 6(b)(1)(A) of SIPA Touche Ross has been engaged as the accounting firm by various trustees in eight proceedings under SIPA. Of

these, five were commenced prior to the completion of Touche Ross' audit of Weis Securities, Inc. which is the subject of this action ("Weis Audit").

TOUCHE ROSS' ENGAGEMENT IN SIPA PROCEEDINGS IN THE SOUTHERN DISTRICT OF NEW YORK

4. Before and during the Weis Audit, Touche Ross was involved in two SIPA proceedings in the Southern District of New York, namely, the liquidation of J. R. Radin & Co., Inc. ("Radin") and Kenneth Bove & Co. ("Bove"). The *Radin* proceeding was commenced by SIPC on March 9, 1972 and the *Bove* proceeding was commenced by SIPC on May 25, 1972.

5. In the *Radin* proceeding, the trustee appointed for the liquidation of Radin was William W. Golub, Esq., a member of the law firm Rosenman, Colin, Freund, Lewis & Cohen (the "Rosenman Firm") which also represents Touche Ross in this action. Mr. Golub was appointed on March 9, 1972. With SIPC's approval, Mr. Golub retained Touche Ross as his accountants for the purpose of that proceeding. Annexed hereto are copies of (i) Touche Ross' letter to Mr. Golub dated March 14, 1972 referring to its engagement retention by Mr. Golub, and (ii) Mr. Golub's letter to SIPC dated March 17, 1972 requesting SIPC's authorization to retain Touche Ross as his accountants. These letters are respectively designated Exhibits A and B.

6. In the *Bove* proceedings, Mr. Golub was first appointed as temporary receiver on May 25, 1972, and on August 17, 1972 as liquidating trustee. In his capacity as temporary receiver, Mr. Golub engaged Touche Ross as his accountants, and that engagement continued after his appointment as trustee. Annexed hereto as Exhibit C is a copy of a revised invoice dated August 3, 1972 submitted by Touche Ross to Mr. Golub for services rendered during

the month of May 1972. There were numerous other invoices but this particular one establishes that Touche Ross was actively engaged on Mr. Golub's behalf while the Weis Audit was in progress.

7. Deponent is informed by SIPC's Finance Department that the following Touche Ross personnel were engaged on Mr. Golub's behalf in one or more of the capacities indicated in the cases specified:

Name	Capacity	Radin	Bove
Louis Haag	Partner		X
Karl Brunhuber	Manager	X	X
John Burkhardt	Manager		X
Stuart Newman	Manager	X	
Irwin Goldberg	Manager	X	
Joseph Puglisi	Supervisor	X	
Mark Berlin	Supervisor		X
Robert Gubitosi	Senior	X	X
Thomas Hogan	Senior		X
James Reilly	Senior	X	
James Blow	Assistant		X
James Buck	Assistant		X
Bruce Price	Assistant		X
Vincent Criscillo	Assistant	X	

Touche Ross' answers to the plaintiffs' interrogatories dated July 23, 1976 (Answer to Interrogatory No. 2) identify each of the foregoing as persons in Touche Ross' employ who were engaged in the Weis Audit.

8. The Rosenman Firm served as counsel to Mr. Golub in both the *Radin* and *Bove* cases.

Other SIPA Proceedings In Which Touche Ross Was Engaged

9. Touche Ross' engagement in SIPA proceedings antedates its engagement in the *Radin* and *Bove* matters, as illustrated by the following.

10. *Carl Berglund d/b/a Colonial Investment Securities ("Colonial")*. In the *Colonial* matter, the trustee was appointed on August 6, 1971 by the U.S. District Court for the District of Massachusetts. Annexed hereto as Exhibit D is a copy of Touche Ross' letter to SIPC's General Counsel dated August 11, 1971 wherein it requested approval of its engagement as the trustee's accountant.

11. *John Edward & Co. Inc. ("Edward")*. In the *Edward* matter, the trustee was appointed on July 1, 1971 by the U.S. District Court for the District of Massachusetts. Annexed hereto are copies of (i) Touche Ross' letter to the trustee dated September 1, 1971 concerning its engagement by the trustee, (ii) a letter from the trustee's attorneys to SIPC dated September 2, 1971 requesting SIPC's approval of the trustee's engagement of Touche Ross, and (iii) SIPC's letter (by L. W. McChesney) to the trustee's attorneys dated September 7, 1971 which approved Touche Ross' engagement. These are designated as Exhibits E, F, and G.

12. *C. H. Wagner & Co. Inc. ("Wagner")*. In the *Wagner* matter, the trustee was appointed on February 28, 1972 by the U.S. District Court for the District of Massachusetts. Annexed hereto as Exhibit H is a copy of Touche Ross' letter to SIPC's General Counsel dated March 16, 1972 concerning the trustee's engagement of Touche Ross in that proceeding.

13. In addition to the foregoing, Touche Ross has served as the accounting firm engaged by trustees in the following cases:

(a) The liquidation under SIPA of Comstock Securities Limited in which the trustee was appointed on November 20, 1972 by the U.S. District Court.

(b) The liquidation under SIPA of First Midwest Investment Corporation in which the trustee was appointed on November 28, 1972 by the U.S. District Court for the Eastern District of Wisconsin.

(c) The liquidation under SIPA of Christian-Paine & Co., Inc. in which the trustee was appointed on April 18, 1974 by the U.S. District Court for the District of New Jersey.

14. Deponent has not ascertained the extent to which Touche Ross personnel who were engaged in the Weis Audit were also engaged in the foregoing six proceedings under SIPA.

WHEREFORE, deponent respectfully prays that the motion of the defendant under Rule 12(b)(1) and (6) of the Federal Rules of Civil Procedure be in all respects denied.

/s/ WILFRED R. CARON
Wilfred R. Caron

[Jurat and Exhibits
omitted in printing]

**Affidavit of Clarence Fried
in Opposition to Motion to Dismiss**

Filed January 10, 1977

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

CLARENCE FRIED, being duly sworn, deposes and says:

1. I am a member of the firm of Hawkins, Delafield & Wood, attorneys for Securities Investor Protection Corporation ("SIPC"), one of the two plaintiffs in this action, and am fully familiar with the proceedings herein. I submit this Affidavit, together with the accompanying Affidavit of Wilfred R. Caron, in opposition to the present motion by defendant Touche Ross & Co. ("Touche Ross") for an order (i) dismissing the complaint herein, each of the causes of action therein alleged, and this action, on the grounds of lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, and (ii) to the extent that the foregoing relief is not granted, staying this action pending determination of a parallel action between the same parties as herein in the Supreme Court of the State of New York, New York County (the "State Court Action").

2. The plaintiffs in this action seek to recover the damages they suffered as a direct result of Touche Ross' failure to properly perform certain accounting services for Weis Securities, Inc. ("Weis"), a brokerage firm being liquidated under the Securities Investor Protection Act of 1970 ("SIPA"). Because of the liquidation of Weis and

pursuant to the obligation created by SIPA, plaintiff SIPC has paid over $14,000,000 to satisfy the claims of approximately 34,000 customers of Weis and may incur further expenses. Had Touche Ross performed its accounting services properly the Weis liquidation might have been avoided and certainly the cost to SIPC would have been substantially less.

THIS ACTION AND THE STATE COURT ACTION

3. In this action, SIPC seeks to recoup from Touche Ross, a firm of certified public accountants, the monies paid to the customers of Weis. SIPC's four initial counts (*i.e.*, the first through the fourth, Comp. ¶¶50-69) are predicated on Touche Ross' violation of the Securities Exchange Act of 1934 (the "1934 Act"). In addition, SIPC asserts four claims (i.e., the fifth through the eighth, Comp. ¶¶70-85) based on common law principles. The federal court's jurisdiction with respect to SIPC's counts arising under the 1934 Act is exclusive because of Section 27 of that Act. Thus, the federal court is the only court which can completely dispose of all the possible issues here involved, state as well as federal.

4. While the factual allegations in the State Court Action are similar to the allegations herein, the counts asserted by SIPC in the State Court Action are necessarily more limited than those contained in the complaint which Touche Ross would have this court dismiss. Obviously, the state court lacks jurisdiction to entertain SIPC's counts arising under the 1934 Act.

5. The State Court Action was instituted by the service of a summons without a complaint in July of 1975 as a precautionary measure to preserve the plaintiffs' state claims from the bar of the statute of limitations. By a series of letter agreements (dated July 2, 1975; December 19, 1975; and March 25, 1976) the parties to the State

Court Action agreed that all applicable statutes of limitations and time limits which had not run by July 2, 1976 were tolled and extended. The last in this series of letter agreements, dated March 25, 1976, a copy of which is annexed hereto as Exhibit A, provided in pertinent part:

> "The undersigned [Touche Ross] hereby confirms and agrees that all statutes of limitations and time limits applicable to any and all claims, or possible claims, against the undersigned by the Trustee and by SIPC, or by either of them, arising out of auditing and accounting services rendered by the undersigned to Weis Securities, Inc., which had not run before July 2, 1975, are further tolled and extended to May 3, 1976. Further, the undersigned agrees not to assert, and hereby waives any defense based upon the omission by the Trustee and by SIPC, or by either of them, to take legal action against the undersigned on and after the date hereof, to and including May 3, 1976, without prejudice to any defense based on such omission to take legal action prior to July 2, 1975."

6. Pursuant to the letter agreement of March 25, 1976, this action was commenced, by the filing of the complaint herein, on April 30, 1976. The complaint in the State Court Action was served several days later on May 3, 1976. Prior to the filing of the complaint herein, Touche Ross was obviously aware of the possibility that a federal court action would be commenced against it by SIPC and the Trustee in addition to the already-instituted State Court Action, because the letter agreements tolling and extending the running of the applicable statutes of limitations were entered into subsequent to the commencement of the State Court Action but prior to the commencement of this action.

7. Since its inception, the State Court Action—unlike this action—has been practically dormant. Touche Ross has neither answered nor moved with respect to the state

court complaint. Its time to do so has been extended by the most recent in a series of stipulations, dated October 28, 1976, a copy of which is annexed hereto as Exhibit B, to the forty-fifth day after the final determination by this court of the instant motion. That stipulation also provides that all proceedings in the State Court Action shall be stayed until a final determination by this court of the instant motion. Moreover, no disclosure has been obtained from any party in the State Court Action. In that action, defendant had propounded a set of interrogatories on each of the plaintiffs and had served notices to take the depositions of each of the plaintiffs. However, these interrogatories and notices of depositions were withdrawn pursuant to the aforementioned stipulation in the State Court Action. In sum, therefore, plaintiffs have not done anything in the State Court Action, except serve a summons and complaint on defendant.

8. In this action, on the other hand, Touche Ross has already partially answered a set of interrogatories propounded by the plaintiffs herein. In addition, to the extent that Touche Ross objected to those interrogatories, the plaintiffs herein moved to compel further answers and a hearing before Magistrate Schreiber was scheduled. By a stipulation in this action,* that motion was withdrawn without prejudice and the need for the hearing was obviated.

9. Thus, the facts indicate that, as between this action and the State Court Action, this action is the more comprehensive and farther advanced. In addition, I respectfully remind this court that, unlike the New York State court, it has special expertise and familiarity with SIPA liquidations, and particularly with the proceedings which have resulted from the liquidation of Weis.

* For the convenience of the court, a copy of the stipulation, "so ordered" by Judge Wyatt on November 12, 1976, is annexed hereto as Exhibit C.

The Absence of a Touche Ross Partner Resident in Washington, D.C.

10. Touche Ross challenges the jurisdiction of this court over SIPC's claims in this action on the ground, *inter alia,* that the citizenship of SIPC and Touche Ross is not diverse for the purposes of 28 U.S.C. §1332. Touche Ross contends that SIPC's failure to allege that no Touche Ross partner resides in Washington, D.C., of which SIPC is a citizen, renders the invocation of that Section as a basis for this court's jurisdiction defective. Significantly, however, Touche Ross has failed to submit any evidence indicating that one of its partners does reside in the District of Columbia. Touche Ross' failure to submit such evidence is understandable in view of the apparent facts. On information and belief, no Touche Ross partner resides in Washington, D.C. The information upon which this belief is based is contained in the Directory for 1976-77 of Touche Ross partners and managers. The partners listed therein under the heading "Washington, D.C." do not include a single individual who resides in the District of Columbia. Rather, all of Touche Ross' Washington, D.C. partners appear to reside in either Maryland or Virginia. The relevant portion of the Touche Ross Directory for 1976-77 is annexed hereto as Exhibit D.

11. In light of the facts contained in this Affidavit and in the accompanying Affidavit of Wilfred R. Caron, and for the reasons set forth in SIPC's accompanying memorandum of law, it is respectfully submitted that the instant motion of defendant Touche Ross be in all respects denied.

/s/ Clarence Fried
Clarence Fried

[Jurat and Exhibits omitted in printing]

Affidavit of Bruce E. Baker in Opposition to Motion to Dismiss

Filed January 10, 1977
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

BRUCE E. BAKER, being duly sworn, deposes and says:

1. I reside at 47 Orange Drive, Jericho, New York. I am the head of the administrative staff maintained for Weis Securities matters by Edward S. Redington, Esq., Trustee for the liquidation of the business of Weis Securities, Inc. pursuant to the Securities Investor Protection Act of 1970. I make this affidavit in opposition to a motion by defendant Touche Ross & Co. to dismiss this action on jurisdictional and other grounds.

2. Pursuant to court order dated June 1, 1973, all proofs of claim and customer claims asserted in the Weis liquidation have been filed with the Trustee as directed by the court order. Upon receipt, proofs of claim were time- and date-stamped and then placed in appropriate files by the Trustee's administrative staff. The files containing the proofs of claim and any related correspondence or documentation are maintained by the Trustee's administrative staff under my supervision and control.

3. Annexed hereto as Exhibit A is a true copy from the Trustee's files of one of the two proofs of claim filed in the Weis liquidation by defendant Touche Ross & Co. The stamp on the face of the proof of claim indicates that it was received by the Trustee's administrative staff at 11:31 A.M. on July 13, 1973. The notations "'A'" and

"total $87,107.00" on the face of the proof of claim were added by a member of the Trustee's administrative staff for processing purposes.

4. Annexed hereto as Exhibit B is a true copy from the Trustee's files of a second proof of claim filed in the Weis liquidation by defendant Touche Ross & Co. for "services rendered for benefit of estate." Again, a stamp on the face of the proof of claim indicates that it was received by the Trustee's administrative staff at 11:31 A.M. on July 13, 1973. The notation "'B'" and the accompanying scribble on the upper righthand corner of the face of the proof of claim were added by a member of the Trustee's administrative staff for processing purposes.

WHEREFORE, deponent respectfully requests that since defendant Touche Ross & Co. has consented to the jurisdiction of this Court by filing the claims identified in paragraphs 3 and 4, its motion to dismiss the Trustee's claims for relief on jurisdictional grounds be denied.

/s/ BRUCE E. BAKER
Bruce E. Baker

[Jurat omitted in printing]

Exhibit A to Affidavit
of Bruce E. Baker

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff,*	
SECURITIES INVESTOR PROTECTION CORPORATION, *Applicant,*	73 Civ. 2332
v.	
WEIS SECURITIES, INC., *Defendant.*	

PROOF OF CLAIM BY INDIVIDUAL

STATE OF
COUNTY OF } ss.:

Touche Ross & Co. of No. 1633 Broadway Street, in New York, County of New York, State of New York, says:

1. That Weis Securities, Inc., the above-named defendant, was at and before May 24, 1973 and still is, justly and truly indebted [*or* liable] to the undersigned in the sum of $75,443 dollars.

2. That the consideration of this debt [*or* liability] is as follows: see attached

3. That no part of the debt [*or* liability] has been paid except none

4. That there are no set-offs or counterclaims to the debt [*or* liability] except none

5. That this creditor does not hold, and has not, nor has any person by his order, or to his knowledge or belief, for his use, had or received, any security or securities for the debt [*or* liability] except none

6. [*If the debt or liability is founded upon an instrument of writings*] That the instrument upon which the debt [*or* liability] is founded is attached hereto [*or* is lost or destroyed, as set forth in the affidavit attached hereto].

7. [*If the debt is founded upon an open account*] that the debt was [*or* will become] due on
[*or* that the average due date thereof is],
that no note or other negotiable instrument has been received for such account or any part thereof [*or* that the debt is evidenced by a note [*or* other negotiable instrument], which is attached hereto]; and that no judgment has been rendered thereon, except

Dated at New York, this 11th day of July, 1973.

/s/ TOUCHE ROSS & CO.
Creditor

/s/ LOUIS J. HAAG,
Partner

There are penalties for presenting fraudulent claims.

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 10, 1973

Mr. Edward S. Redington
Trustee in Liquidation of
Weis Securities Inc.
Hughes, Hubbard & Reed
One Wall Street
New York, N.Y. 10005

FOR SERVICES RENDERED to Weis Securities Inc.

For services rendered covering the regular New York Stock Exchange, Inc. audit as of April 27, 1973 for the purpose of examining the Answers to Financial Questionnaire and Statement of Financial Condition as of that date. (Examination was not completed nor were reports submitted)	$67,972
Services rendered by our London office covering the examination of the accounts and records, systems review and accounting systems of Weis, Voisin & Co., Inc.—London Branch and Weis, Voisin & Co. International Limited, as of November 24, 1972— £2,077.64	5,313
Services rendered by our Paris Office covering the examination of financial statements of Weis, Voisin S.A.R.L.—Paris as of November 24, 1972, value added tax problem and meeting to discuss present and future operations, F.7,350	1,900
Services rendered by our Paris Office covering the preparation of the French corporate income tax return for Weis, Voisin S.A.R.L.—Paris for the year ended December 31, 1972 filed April 30, 1973— F.1,000	258
Total	$75,443

Exhibit B to Affidavit
of Bruce E. Baker

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

SECURITIES INVESTOR PROTECTION CORPORATION,
Applicant,

v.

WEIS SECURITIES, INC.,
Defendant.

73 Civ. 2332

PROOF OF CLAIM BY INDIVIDUAL

STATE OF
COUNTY OF } ss.:

Touche Ross & Co., of No. 1633 Broadway Street, in New York, County of New York, State of New York, says:

1. That Weis Securities, Inc., the above-named defendant, was at and before May 24, 1973 and still is, justly and truly indebted [*or* liable] to the undersigned in the sum of $11,664 dollars.

2. That the consideration of this debt [*or* liability] is as follows: see attached

3. That no part of the debt [*or* liability] has been paid except none

4. That there are no set-offs or counterclaims to the debt [*or* liability] except none

5. That this creditor does not hold, and has not, nor has any person by his order, or to his knowledge or belief, for his use, had or received, any security or securities for the debt [*or* liability] except none

6. [*If the debt or liability is founded upon an instrument of writings*] That the instrument upon which the debt [*or* liability] is founded is attached hereto [*or* is lost or destroyed, as set forth in the affidavit attached hereto].

7. [*If the debt is founded upon an open account*] That the debt was [*or* will become] due on
[*or* that the average due date thereof is
], that no note or other negotiable instrument has been received for such account or any part thereof [*or* that the debt is evidenced by a note [*or* other negotiable instrument], which is attached hereto]; and that no judgment has been rendered thereon, except

Dated at New York, this 11th day of July, 1973.

/s/ TOUCHE ROSS & CO.
Creditor

/s/ LOUIS J. HAAG,
Partner

There are penalties for presenting fraudulent claims.

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 10, 1973

Mr. Edward S. Redington
Trustee in Liquidation of
Weis Securities Inc.
Hughes, Hubbard & Reed
One Wall Street
New York, N.Y. 10005

FOR SERVICES RENDERED to Weis Securities Inc.

For services rendered for benefit of estate:

Meetings and conferences with personnel of the New York Stock Exchange, Inc. and the Securities and Exchange Commission;	$ 4,537
Substantiation and documentation of alleged fraudulent bookkeeping practices and entries;	2,975
Confirmation of bank loans and related collateral as of April 13, 1973 applicable to the alleged fraudulent bookkeeping entries	4,152
Total	$11,664

Reply Affidavit of Arnold I. Roth in Support of Motion to Dismiss

Filed February 7, 1977

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

ARNOLD I. ROTH, being duly sworn, deposes and says:

1. On January 20, 1977, after plaintiffs had served their opposing papers herein, the Second Circuit decided *Lank* v. *New York Stock Exchange* (Docket No. 76-7243). For the convenience of the Court, and because *Lank* is controlling here (a controlling effect which is conceded by plaintiffs, who rely heavily upon the reversed District Court decision) and requires dismissal of plaintiffs' "causes of action" under Section 17 of the 1934 Act, a copy of the Second Circuit's slip opinion is annexed hereto as Exhibit 1.

2. Among the pertinent materials for replying to plaintiffs' opposing papers are the annual reports of plaintiff SIPC. Consequently, pertinent portions of plaintiff SIPC's First Annual Report (1971), Second Annual Report (1972), Third Annual Report (1973) and Fifth Annual Report (1975) are annexed hereto as, respectively, Exhibits 2, 3, 4 and 5.

3. Arguing against the alternative relief sought by defendant Touche Ross—*viz.*, a stay of all proceedings in this action, to the extent that it is not dismissed, pending determination of plaintiffs' earlier commenced and almost identical State Court Action—plaintiffs seek (by means of the moving affidavit of Clarence Fried) to create the

misleading impression that the State Court Action had to be commenced for protection against the statute of limitations, that the State Court Action has been dormant since its inception, and that this action is substantially more advanced than the State Court Action. Brief recitation of the facts demonstrates the misleading nature of plaintiffs' contentions.

(a) Mr. Fried asserts that the State Court Action was instituted "as a precautionary measure to preserve the plaintiffs' state claims from the bar of the statute of limitations" (Fried Aff. ¶5). However, by the time the State Court Action was commenced on July 3, 1975, plaintiffs and defendant Touche Ross had already entered into the first of the series of letter agreements by which even Mr. Fried concedes "all applicable statutes of limitations and time limits . . . were tolled and extended". That first letter agreement was dated July 2, 1975, and was supplemented by further letter agreements dated December 19, 1975 and March 25, 1975. Since Mr. Fried attaches to his affidavit only the last of those letter agreements, the first two are annexed hereto as, respectively, Exhibits 6 and 7. In this connection, I call the Court's attention to the fact that Mr. Fried misstates the operative language (which is the same in all three letters) when he quotes it as saying "all applicable statutes of limitations and time limits which had not run by *July 2, 1976* were tolled and extended". The misstatement by Mr. Fried is with respect to the underlined date, for in each of the letter agreements the actual date is not July 2, 1976, but instead, *July 2, 1975,* the day before the commencement of the State Court Action. Thus, the parties had agreed prior to the commencement of the State Court Action to toll and extend all applicable statutes of limitations, and *the commencement of the State Court Action for that purpose was (and was known to plaintiffs to be) unnecessary.*

(b) In asserting that the State Court Action "has been practically dormant", Mr. Fried erroneously asserts that defendant Touche Ross "has neither answered nor moved" therein and, while conceding that defendant Touche Ross "propounded a set of interrogatories on . . . and . . . served notices to take the depositions of each of the plaintiffs", misleadingly suggests that defendant Touche Ross withdrew those interrogatories and notices without more (Fried Aff. ¶7). In fact, defendant Touche Ross not only served its extensive interrogatories and its notices to take depositions (referred to in my moving affidavit), but also moved to dismiss portions of the complaint in the State Court Action. A copy of the defendant Touche Ross' notice of motion to dismiss is annexed hereto as Exhibit 8.

(c) To support the suggestion that this action is more advanced than the State Court Action, Mr. Fried misleadingly asserts that defendant Touche Ross "has already partially answered a set of interrogatories propounded by the plaintiffs herein" (Fried Aff. ¶8). However, defendant Touche Ross' answers do not represent the advancement of this action which plaintiffs would suggest. After the complaint in this action was served, defendant Touche Ross sought an extension of its time to move or answer in order to be able adequately to deal with the numerous and complex issues which, as it informed plaintiffs, it intended to raise on a motion to dismiss. Plaintiffs' attorneys were unwilling to grant the necessary and concededly reasonable extensions without demanding as a *quid pro quo* a concession from defendant Touche Ross that they could, *inter alia,* serve certain interrogatories. Although defendant Touche Ross expressly objected to any discovery taking place prior to determination of the motion to dismiss and to the exaction of the *quid pro quo,* it was forced to agree (in order to obtain plaintiffs' agreement to the necessary extension) that plaintiffs could, *inter alia,*

serve interrogatories which "shall be of a preliminary or structural nature, and shall not seek information on the substance of the causes of action alleged in the complaint". Contrary to the express requirements of the stipulation embodying that agreement, a copy of which is annexed hereto as Exhibit 9, and as defendant Touche Ross had feared, the interrogatories actually served by plaintiffs sought extensive information which was non-preliminary and was of a substantive nature. Despite the improprieties of the interrogatories, defendant Touche Ross responded to them by answering them to the extent that they were within the scope of the stipulation and otherwise proper, and by objecting to them to the extent that they were beyond the scope of the stipulation or otherwise improper. The answers, which primarily identify certain personnel of and documents issued by defendant Touche Ross, are of the most "preliminary" nature, and do not go to the substance of the issues in this action. The answers to the interrogatories do not constitute any substantial start on discovery, and no other discovery has occurred in this action.

(d) By October 1976, the parties hereto were involved in a number of procedural and substantive motions in this action and the State Court Action. Defendant Touche Ross had made the present motion to dismiss this action. Defendant Touche Ross had made its motion to dismiss portions of the State Court Action. Plaintiffs, seeking to whipsaw defendant Touche Ross on discovery, had moved in this action to compel defendant Touche Ross to further answer their improper interrogatories, while at the same time moving in the State Court Action to block defendant Touche Ross from obtaining the discovery sought by its interrogatories and notices of depositions therein. In late October 1976, the parties agreed that all proceedings in this action and the State Court Action should be held in abeyance pending

the resolution of the present motion to dismiss this action, and effectuated that agreement by entering into the two stipulations dated October 28, 1976 and annexed to Mr. Fried's affidavit as Exhibit B.

4. The point of the foregoing is that this action is no further advanced than the State Court Action, and plaintiffs mislead in suggesting to the contrary. Consequently, the relative procedural postures do not militate against the stay and, in light of the fact that the State Court Action was commenced long before this action, actually weigh in favor of the stay. Other pertinent factors which also dictate that the stay be granted are discussed in detail in defendant Touche Ross' moving papers and include such overriding considerations as the fact that plaintiffs' claims involve basically questions of common law negligence and malpractice, and the fact that such questions are more appropriately to be resolved by the State courts.

5. A decision pertaining to the question of a stay is *Finkelstein* v. *Wolf,* a summary of which is reported at C.C.H. Fed. Sec. L. Rep. ¶94,885 (1974). A full copy of that decision is annexed hereto as Exhibit 10.

/s/ ARNOLD I. ROTH
Arnold I. Roth

[Jurat and Exhibits omitted in printing]

[428 F. Supp. 483]

Opinion of the District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[March 1, 1977]

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs,

—against—

TOUCHE ROSS & Co.,
Defendant.

76 Civ. 1981

APPEARANCES:

HUGHES HUBBARD & REED, ESQS.
Attorneys for Plaintiff Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc.
One Wall Street
New York, New York 10005

JOHN S. ALLEE, ESQ.
JAMES B. KOBAK, JR., ESQ.
WILLIAM S. BARRETT, ESQ.
of Counsel

HAWKINS, DELAFIELD & WOOD, ESQS.
Attorneys for Plaintiff
Securities Investor Protection Corporation
67 Wall Street
New York, New York 10005

CLARENCE FRIED, ESQ.
WILFRED R. CARON, ESQ.
MICHAEL S. DOW, ESQ.
RAFAEL PASTOR, ESQ.
of Counsel

ROSENMAN COLIN FREUND LEWIS & COHEN, ESQS.
Attorneys for Defendant Touche Ross & Co.
575 Madison Avenue
New York, New York 10022

ARNOLD I. ROTH, ESQ.
JAMES K. NEVLING, JR., ESQ.
ARTHUR LINKER, ESQ.
MARC S. DREIER, ESQ.
STEVEN A. ASHER, ESQ.
of Counsel

[428 F. Supp. 485]

WYATT, District Judge.

This is a motion by defendant Touche Ross & Co. (Touche) to dismiss the complaint pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, on two grounds: that the Court lacks subject matter jurisdiction, and that the complaint fails to state a claim upon which relief can be granted; in the alternative, it is sought to stay this

[428 F. Supp. 486]

action pending determination of an action between the same parties in the New York Supreme Court, New York County.

1.

Weis Securities, Inc. (Weis), was a large stock brokerage house. Weis was a broker-dealer registered with the Securities and Exchange Commission (SEC) and was a member of the New York Stock Exchange and of other stock exchanges. Weis is said to be a corporation, although where incorporated does not appear; its principal place of business is said to have been in the City of New York.

Touche is a firm of certified public accountants and acted as such for Weis.

In May 1973, Securities Investor Protection Corporation (SIPC) applied to this Court for a decree adjudicating, under the Securities Investor Protection Act of 1970 (15 U.S.C. §§ 78aaa and following; "SIPA"), that customers of Weis were in need of protection under SIPA, appointing a trustee for the liquidation of Weis, and affording other relief. This Court granted the application and appointed Edward S. Redington as Trustee (referred to usually as the "Trustee"). The proceedings in which the Trustee was appointed are described in *Exchange National Bank v. Wyatt,* 517 F.2d 453 (2d Cir. 1975). The Trustee was appointed on May 30, 1973; the "filing date" (15 U.S.C. § 78eee(b)(4)(B)) was May 24, 1973. Weis has since been in liquidation under SIPA.

2.

On July 3, 1975, the Trustee and SIPC commenced an action against Touche in New York Supreme Court, New York County (Index No. 13996/76; the action has a 1976 number because the first paper filed in the action was in 1976). The causes of action of each plaintiff were separately stated but there were in the complaint 21 paragraphs of "common allegations" which were then incorporated by reference in each claim of the Trustee and in each claim of SIPC. There were five causes of action by the Trustee and four causes of action by SIPC.

3.

The case at bar was commenced in this Court on April 30, 1976. The parties are the same as those in the State action. The Trustee and SIPC are again suing Touche.

The complaint in the case at bar asserts exactly the same claims as in the State action and adds claims by the Trustee and SIPC based on alleged violations by Touche

of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a and following; "the 1934 Act"), specifically of Section 17 of the 1934 Act (15 U.S.C. § 78q).

The "common allegations" are the same in both actions except that three paragraphs have been added here to shore up the added Section 17 claims of the Trustee and SIPC.

In this action, there are 6 claims by the Trustee and 8 claims by SIPC. (The claims are mistakenly called causes of action in the complaint, ignoring Fed.R.Civ.P. 8 and following the nomenclature in the State courts.)

The two plaintiffs have joined as such (presumably under Fed.R.Civ.P. 20(a) and properly) but their claims are several, not joint, and are stated in separate counts.

Counts two through six of the complaint in the case at bar are exactly the same as the five causes of action of the Trustee in the State action. Count one in the case at bar is the added claim under Section 17 of the 1934 Act.

The first four claims of SIPC in the case at bar are not in the State Action and are apparently intended to be based on Section 17 of the 1934 Act although in the first four counts there is no express reference to Section 17 (except as paragraphs 1, 16, 17, 21, and 22 of the complaint are incorporated by reference in these counts). The other four SIPC claims in the case at bar are exactly the same as the four SIPC causes of action in the State action.

[428 F. Supp. 487]

4.

The claims in the case at bar are alleged to arise under the 1934 Act and particularly under Section 17 thereof (15 U.S.C. § 78q), under Section 6 of SIPA (15 U.S.C. § 78fff), and under the common law (complaint, para 1).

The complaint avers that the Court has jurisdiction over the claims of the Trustee under Section 27 of the 1934 Act and under 28 U.S.C. § 1331. It further avers (in effect) that the Court has jurisdiction in bankruptcy by virtue of Section 6 of SIPA (15 U.S.C. § 78fff), under Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. §§ 11a(7), 502 and 515), and under 28 U.S.C. § 1334. The complaint also avers jurisdiction over the common law claims of the Trustee under principles of pendent jurisdiction (complaint, para 2).

Jurisdiction over SIPC's claims is alleged to exist under Section 27 of the 1934 Act and 28 U.S.C. § 1331, under the diversity of citizenship statute (28 U.S.C. § 1332) and under principles of pendent jurisdiction (complaint, para 3).

There then follows a series of "Common Allegations" comprising 24 paragraphs of the complaint which are incorporated by reference in both the six counts pleaded by the Trustee and the eight counts pleaded by SIPC.

The complaint avers that five of Weis' officers misstated the financial condition and results of operation of Weis in financial reports prepared at the end of fiscal year 1972, and that such reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act. It alleges that these reports were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders.

Plaintiffs aver that Touche breached duties it assumed toward them under Section 17 of the 1934 Act and under the common law when it became Weis' auditor and undertook to perform all necessary auditing and accounting services needed to audit the reports of financial condition that Weis was required to submit to the SEC. Essentially, these "common allegations" charge Touche with negligence and recklessness in the performance of its services (para 28); SIPC argues that they also

charge wilful misconduct (Memorandum of Plaintiff SIPC in Opposition to Defendant's Motion to Dismiss, p. 5). The complaint also alleges that Touche falsely certified that it had performed the necessary services and made false representations with respect to the Answers to Financial Questionnaire and other documents dated May 26, 1972. The "common allegations" then state that because of these failures and misrepresentations of Touche, the Exchange, the SEC and SIPC were prevented from knowing the true condition of Weis, and were prevented from acting to safeguard the assets of Weis and the property held by Weis for its customers; and that Weis continued to undertake financial obligations which it could not satisfy. As a result of the failure to act of the regulatory authorities, the liquidation of Weis became necessary when the facts were discovered. This was after the Weis assets and the property held by it for customers had been further depleted, and when it was too late to take remedial action. Upon liquidation, SIPC was required under SIPA to provide the Trustee with funds for the payment of claims submitted by customers and "certain other creditors" of Weis.

Paragraphs 32-49 of the complaint state six claims by the Trustee against Touche. The first claim charges that Touche violated, and aided and abetted the Weis officers in violating, Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, which require broker-dealers (such as Weis) to file accurate reports of their financial condition, including reports such as those certified by Touche. It further states (para 34) that "Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the class of persons which Section 17 of the 1934 Act was designed to protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934

Act",

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and that the injuries which occurred as a result of the liquidation of Weis were of the type that Section 17 was intended to prevent.

The Trustee's other five claims state that Touche breached duties to Weis under the common law of New York. The second claim charges Touche with negligence per se in violating Section 17 of the 1934 Act. The third charges Touche with negligence and malpractice. The fourth charges Touche with recklessness and gross negligence. The Trustee's fifth claim charges breach of contract. The sixth claim charges breach of express and implied warranties that Touche would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC.

In paragraphs 52-85 of the complaint, SIPC alleges eight claims against Touche, four on its own behalf and four on behalf of Weis' customers and certain other creditors. The first four claims allege violations of Section 17 of the 1934 Act and the others allege violations of the common law.

SIPC's first claim is under Section 17 of the 1934 Act and charges that Touche failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules promulgated thereunder in that opinion letters, answers to the financial questionnaire and financial statements prepared by Touche were false, inaccurate and incomplete, and that as a consequence the SIPC fund has been depleted in order to satisfy the claims of 34,000 customers and other creditors. Its third claim (also under Section 17) charges that Touche had knowledge, or, but for its errors and omissions, would have had knowledge, of the deceptions caused by the Weis officers in violation of the 1934 Act and that Touche aided and abetted the Weis officers in this

deception. The fifth claim (under common law) charges Touche with negligence and malpractice. The seventh claim (under common law) charges Touche with recklessness and gross negligence. SIPC's second, fourth, sixth and eighth claims are the same respectively as the first, third, fifth and seventh claims above described except that the second, fourth, sixth and eighth claims aver that Touche violated duties to the customers and certain other creditors of Weis and that SIPC is subrogated to the claims which such customers and other creditors could have asserted, this because SIPC has compensated them out of the SIPC fund.

5.

As seen above, the Trustee's first claim and the first, second, third, and fourth claims of SIPC are asserted under Section 17 of the 1934 Act (15 U.S.C. § 78q).

The argument for Touche is that there is no provision in Section 17 for a private right of action (as, for example, there is in Section 16) and that no private right of action is maintainable under Section 17.

The argument for plaintiffs is that, while no private right of action is expressly provided for in Section 17, a right of action should be implied for parties such as SIPC, the Trustee and customers and creditors of Weis who are said to fall within the "class for whose *especial* benefit the statute was enacted", citing *Cort* v. *Ash*, 422 U.S. 66, 78, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975; emphasis in original), which quoted from *Texas & P.R. Co.* v. *Rigsby*, 241 U.S. 33, 39, 36 S.Ct. 482, 60 L.Ed. 874 (1916).

6.

If there were any violations by Touche of Section 17, they occurred in 1972. Since then, there have been extensive amendments (in 1975) to Section 17 but in 1972 the relevant part of Section 17 read as follows:

> "Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 78o of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other

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> records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

From the wording of this provision and in the context of the other provisions of the 1934 Act, it would appear that Section 17 was designed to supply administrative guidance in the bookkeeping area and not to create any rights in anybody. Section 17 has also been used as authority for the inspection program of the SEC, which is somewhat like the inspection work of the bank examiners.

In the 43 years during which the statute has been on the books, there has been no decision whether a private right of action can be asserted for a violation of Section 17. The Supreme Court, about a year ago, refused to consider whether there was such a private cause of action. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194 fn. 13, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976).

There is nothing explicit to show any legislative intent respecting a private claim under Section 17.

The section, however, is entitled "Accounts and records, reports . . . ." and the very next section is entitled "Liability for misleading statements". This next section, Section 18 (15 U.S.C. § 78r), creates a private cause of action for "misleading statements" in "any application, report, or document filed pursuant to this chapter . . . " in favor of any person who purchased or sold a security at a price affected by the misleading statements. The subject matter of the two sections, their titles, and their juxtaposition would strongly suggest a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18. Plaintiffs here are obliged to argue that there is an implied private claim under Section 17 *broader* than the claim *expressly* created by Section 18. This is because they did not purchase nor sell any security "at a price affected . . . " etc., and thus cannot state a claim under Section 18. In this connection, it may be well to recall the words of the Supreme Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 736, 95 S.Ct. 1917, 1925, 44 L.Ed.2d 539 (1975):

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement . . . '. It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action."

Sections 13(a) and 13(d) of the 1934 Act (15 U.S.C. § 78m(a) and (d)) require the filing of specified reports by issuers and the filing of reports by those who acquire more than 5% of a registered equity security. Claims have been asserted under this Section by those who were not purchasers or sellers of any security and who thus could not state a claim under Section 18. They asked the Courts, as the plaintiffs do here, to imply a private right of action from the section alleged to have been violated. The Courts have declined to do so, holding that Section 18 is the only civil liability provision for a violation of the "reporting provisions" of the 1934 Act. *Meer* v. *United Brands Co.,* CCH Fed.Sec.L.Rep. ¶ 95,648 (S.D.N.Y. July 6, 1976; Carter, J.); *Myers* v. *American Leisure Time Enterprises,* 402 F.Supp. 213 (S.D.N.Y. 1975; Weinfeld, J.), affirmed without opinion 538 F.2d 312 (2d Cir. 1976); *In re Penn Central Securities Litigation,* 347 F.Supp. 1327, 1340 (E.D.Pa. 1972), affirmed 494 F.2d 528 (3d Cir. 1974).

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In *In re Penn Central Securities Litigation,* cited above, the District Court stated (347 F.Supp. at 1340):

> "Section 13 is one of a number of provisions that require the filing of applications, documents and reports. See §§ 12(b), 12(g), 15(b)(1), 15A(a), 16(a) and 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the Exchange Act, and we conclude that it is the exclusive remedy for violation of § 13(a)."

Opposed to the suggestion that the only protection intended for a violation of Section 17 was the liability created in Section 18, is the argument that customers of brokers and dealers in their dealings with such brokers

and dealers can never rely on the relief provided by Section 18 because in such dealings they can never meet the purchaser-seller requirement of that section. Section 17, runs the argument, was intended to protect those who choose to leave securities they have purchased, or cash resulting from securities they have sold, with their broker. Section 17's purpose is to protect these people by requiring their brokers to file reports with the SEC so that the SEC (and now SIPC as well) might police their activities so as to ensure the solvency of brokers.

Although Section 18 might not, of itself, foreclose the implication of a private right of action under Section 17, this does not mean that Section 18 is irrelevant to the question here.

It should be noted that when Congress wanted to create private causes of action for violations of provisions of the 1934 Act, it knew how to do it and did do it. In addition to the "reporting" violations made the subject of private rights of action in Section 18, Congress specifically provided for civil liability in Section 9(e) (15 U.S.C. § 78i(e)) and Section 16(b) (15 U.S.C. § 78p(b)) of the 1934 Act. Congress also provided for "liabilities of controlling persons" in Section 20 of the 1934 Act (15 U.S.C. § 78t).

Nor is it necessary to imply a civil liability under Section 17 in order to enforce its provisions. There can be a criminal prosecution. *United States* v. *Sloan,* 389 F.Supp. 526 (S.D.N.Y. 1975). The SEC can secure an injunction where a violation is proved of Section 17, described by Judge Tenney as "the bookkeeping rule". *SEC* v. *Resch-Cassin & Co., Inc.,* 362 F.Supp. 964, 979 (S.D.N.Y. 1973).

It remains to consider *J. I. Case Company* v. *Borak,* 377 U.S. 428, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) on which plaintiffs properly rely. In *Borak* a private right of action was implied for a violation of Section 14(a) of the

1934 Act (15 U.S.C. § 78n(a)) despite the lack of any provision therein for a private right of action and despite the existence of the civil liability provision in Section 18 (15 U.S.C. § 78r).

Borak was a suit by a stockholder of Case, the management of which solicited proxies for voting in favor of a merger of Case with another corporation. It was alleged that the proxy solicitation material was false and was in violation of Section 14(a) of the 1934 Act; that the merger would not have been approved by stockholders were it not for the false and misleading statements; and that the stockholders of Case had been damaged.

Section 14(a), together with an SEC Rule prescribed thereunder, makes it unlawful to solicit proxies by means of a proxy statement to stockholders containing false or misleading statements.

There is nothing in the statute which requires any filing with the SEC of proxy statements or other soliciting material. But the regulations of the SEC under Section 14(a) require that "preliminary copies" of the proxy statement or other soliciting material be filed with the SEC, as well as "definitive copies". 17 CFR § 240.14a-6

Soliciting material is plainly intended for the information of the stockholders, not of the SEC. The SEC has only an oversight or policing function.

In *Borak* a private right of action was implied because plaintiff, one of the stockholders solicited, was of the class intended to be protected by the statute; and because

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such private action was a "necessary supplement to Commission action" (377 U.S. at 432, 84 S.Ct. 1555) since the SEC had not the time for an "independent examination" of the soliciting material filed with it (377 U.S. at 432, 84 S.Ct. 1555).

But the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any "investors" and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act (Section 8(b); 15 U.S.C. § 78h(b)). Moreover, in examining the records and reports made under Section 17(a) the SEC does not have the time limitations applicable to the *Borak* proxy statements (ten days in some cases (17 CFR § 240.14a-6(a)) and two days in others (17 CFR § 240.14a-6(b)). The SEC has an inspection program, similar to that of bank examinations. It is not "necessary" to enforce Section 17 by private actions; criminal prosecutions and SEC injunctive actions seem abundantly sufficient. If, as is the case, the record keeping requirements of Section 17 are to give early warning to the SEC of financial difficulties of a broker and thus avoid liquidation, it cannot help to imply a private right of action *after* liquidation has become a fact.

The Supreme Court has refused to expand the *Borak* principle; indeed, the Court has restricted it.

In *Cort v. Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975), the Supreme Court refused to imply a private right of action for a violation of 18 U.S.C. § 610. The Court referred to *Borak* as an instance where there was "a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard" (422 U.S. at 82, 95 S.Ct. at 2090). There is no such "pervasive legislative scheme" in the case at bar.

And only last week, the Supreme Court, reversing our Court of Appeals, declined to imply a private right of action under Section 14(e) of the 1934 Act. *Piper* v. *Chris-Craft Industries, Inc.*, ____ U.S. ____, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977).

The test was whether "the creation by judicial interpretation of the implied cause of action . . . is *necessary* to effectuate Congress' goals" (emphasis supplied). This test has already been applied here and no such implication found "necessary".

The Supreme Court determined that plaintiff in *Chris-Craft* was not an intended beneficiary of the legislation. Here, neither the Trustee nor SIPC could possibly have been meant to be protected by Section 17, if for no other reason because the SIPA legislation was not passed until more than thirty years after Section 17. Additionally, neither the Trustee nor SIPC is an investor.

The case of *Lank* v. *The New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977), is instructive in this respect. There our Court of Appeals refused to imply a private right of action in the receiver of a member of the Exchange under Section 6 of the 1934 Act. The Court emphasized that brokers were not investors to be protected by the 1934 Act and that Section 6 was not enacted "for the purpose of affording protection to the very members of the stock exchanges whose conduct was being regulated . . . ". This analysis seems applicable to the plaintiffs in the case at bar.

Finally, Section 17 does not impose any duty on accountants. It specifically mentions a "national securities exchange", the members thereof, a "registered securities association", brokers, and dealers; it does not mention accountants. While the regulations do contain provisions respecting an accountant's certificate (17 CFR § 240.17a-5(f)(g)(h)(i)), the oath is only by the broker or dealer (17 CFR § 240.17a-5(b)(2)). Judge Weinfeld discussed the problem in *Rothstein* v. *Seidman & Seidman*, 410 F.Supp. 244 (S.D.N.Y. 1976) where he emphasized that a "special instruction" of the New York Stock Exchange laid a duty on its members but not on their accountants.

It is concluded that the Trustee's first claim and the first, second, third, and fourth claims of SIPC must be dismissed for failure to state a claim upon which relief can be granted.

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7.

The other five claims of the Trustee are common law claims. The question is whether this Court has any jurisdiction of them. It seems clear that this Court has no jurisdiction.

Pendent jurisdiction will not justify retention of these claims. The federal claim of the Trustee in count one has been dismissed before trial and we are instructed that, in such event, "the State claims should be dismissed as well". *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 726, 86 S. Ct. 1130, 16 L.Ed.2d 218 (1966)

The Trustee asserts an independent basis for jurisdiction under the general language of 11 U.S.C. § 11(a)(7).

The situation at bar, however, is controlled by 11 U.S.C. § 46 which provides that a trustee in bankruptcy may sue only in the courts where the bankrupt might have sued.

Section 6(c)(1) of SIPA (15 U.S.C. § 78fff(c)(1)) states in relevant part:

> "Except as inconsistent with the provisions of this chapter and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of Chapter X and such of the provisions . . . of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive . . .".

Section 502 of Title 11 states in relevant part:

> "The provisions of chapters 1 to 7, inclusive of this title shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 46 . . . shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters 1 to 7, inclusive." (emphasis in original)

Thus Section 46 of Title 11 is applicable to SIPA liquidations.

The arguments for the Trustee have been considered but cannot be accepted.

It may be mentioned that the Trustee urges a consent by Touche to the jurisdiction of this Court, a consent said to flow from the filing by Touche of a claim for professional services in the Weis liquidation. But the claim filed by Touche in the Weis liquidation was for accounting work in *European offices of Weis* in late 1972 and early 1973, as well as for a Stock Exchange audit as of April 27, 1973. The claim by the Trustee against Touche does not arise out of any work done for Weis by Touche and for which Touche filed a claim in the Weis liquidation. The claims are not "mutual" therefore but are unrelated and the consent of Touche cannot be found. *Cherno* v. *Engine Air Service, Inc.*, 330 F.2d 191 (2d Cir. 1964).

Under 11 U.S.C. § 46 we look to see whether Weis could have sued Touche in this Court. It seems undisputed that the principal place of business of Weis (28

U.S.C. § 1332(c)) was in New York and that members of the Touche firm are citizens of New York. Diversity jurisdiction would not exist of an action by Weis against Touche.

The second, third, fourth, fifth and sixth claims of the Trustee must be dismissed for lack of jurisdiction over the subject matter.

8.

The fifth, sixth, seventh, and eighth claims of SIPC are common law claims. As to these, SIPC argues for diversity jurisdiction on the ground that it should be considered for diversity purposes as a District of Columbia corporation. This argument cannot be accepted.

Under SIPA, SIPC was created as a corporation but it distinctly was *not* made a District of Columbia corporation. The relevant part of SIPA (15 U.S.C. § 78ccc(a)(3)) provides that SIPC is "subject

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to" the District of Columbia Nonprofit Corporation Act and has "all the powers" conferred on a nonprofit corporation by that Act. This does not mean, however, that it *is* a District of Columbia corporation. Note should be taken of the Act of Congress creating The American National Red Cross. Named persons are created "a body corporate and politic in the District of Columbia" (36 U.S.C. § 1a). For diversity purposes, the Red Cross is a citizen of the District of Columbia because the statutory language is specific, in marked contrast to that in SIPA. *Patterson* v. *Amer. Nat. Red Cross*, 101 F. Supp. 655 (S. D. Fla. 1951).

SIPC appears to be a federally created corporation which, like the American Legion (36 U.S.C. § 41), the

Disabled American Veterans (36 U.S.C. § 90a) and others, is not a citizen of any state for jurisdictional purposes. *Hancock Financial Corp.* v. *Federal Savings, etc.*, 492 F.2d 1325 (9th Cir. 1974); *Rice* v. *Disabled American Veterans*, 295 F. Supp. 131 (D. C. D. 1968).

There can be no jurisdiction simply because SIPC was created by Act of Congress because there is no stock ownership in SIPC by the United States. 28 U.S.C. § 1349.

Finally, the Trustee is a citizen of New York and is a plaintiff along with SIPC. Partners of Touche, the defendant, are citizens of New York. Thus, there is no complete diversity of citizenship within the rule of *Strawbridge* v. *Curtiss*, 3 Cranch 267, 2 L.Ed. 435 (1806).

The fifth, sixth, seventh, and eighth claims of SIPC must be dismissed for lack of jurisdiction over the subject matter.

Settle order and judgment on notice.

Dated: New York, New York
March 1, 1977

INZER B. WYATT
United States District Judge

Order and Judgment of the District Court

Filed March 15, 1977

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.

Defendant.

76 Civ. 1981 (I.B.W.)

ORDER AND JUDGMENT

Defendant having moved, pursuant to Rule 12(b), F.R.Civ.P., for an order dismissing this action, the complaint herein and each so-called cause of action therein alleged, and granting related relief, and the motion having been duly heard by the Court, and the Court having duly rendered its decision, dated March 1, 1977, granting the motion as hereinafter provided,

It is hereby ORDERED, ADJUDGED AND DECREED that

1. The first claim (called in the complaint "PLAINTIFF TRUSTEE'S FIRST CAUSE OF ACTION") of plaintiff Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc. ("Redington"), and the first, second, third and fourth claims (called in the complaint, respectively, "PLAINTIFF SIPC'S FIRST CAUSE OF ACTION", "PLAINTIFF

SIPC'S SECOND CAUSE OF ACTION", "PLAINTIFF SIPC'S THIRD CAUSE OF ACTION", and "PLAINTIFF SIPC'S FOURTH CAUSE OF ACTION") of plaintiff Securities Investor Protection Corporation ("SIPC") are dismissed on the merits for failure to state a claim upon which relief can be granted;

2. The second, third, fourth, fifth and sixth claims (called in the complaint, respectively, "PLAINTIFF TRUSTEE'S SECOND CAUSE OF ACTION", "PLAINTIFF TRUSTEE'S THIRD CAUSE OF ACTION", "PLAINTIFF TRUSTEE'S FOURTH CAUSE OF ACTION", "PLAINTIFF TRUSTEE'S FIFTH CAUSE OF ACTION", and "PLAINTIFF TRUSTEE'S SIXTH CAUSE OF ACTION") of plaintiff Redington, and the fifth, sixth, seventh and eighth claims (called in the complaint, respectively, "PLAINTIFF SIPC'S FIFTH CAUSE OF ACTION", "PLAINTIFF SIPC'S SIXTH CAUSE OF ACTION", "PLAINTIFF SIPC'S SEVENTH CAUSE OF ACTION", and "PLAINTIFF SIPC'S EIGHTH CAUSE OF ACTION") of plaintiff SIPC are dismissed for lack of jurisdiction over the subject matter;

3. This action is dismissed, and defendant have judgment against plaintiffs, and each of them, dismissing this action.

New York, New York
March 15, 1977

/s/ INZER B. WYATT
U.S.D.J.

JUDGMENT ENTERED—3/15/77

/s/ RAYMOND F. BURGHARDT
CLERK

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 136, 144—September Term, 1977.

(Argued November 14, 1977—Decided April 21, 1978.)

Docket Nos. 77-7183, 77-7186

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—v.—

TOUCHE ROSS & Co.,

Defendant-Appellee.

Before:

LUMBARD, MULLIGAN, and TIMBERS,

Circuit Judges.

Appeal from order of the Southern District of New York dismissing complaint. Inzer B. Wyatt, *J.*, ruled that neither SIPC nor broker's trustee in liquidation could maintain suit against accountant under section 17 of the Securities Exchange Act.

Reversed as to both plaintiffs and remanded.

JAMES B. KOBAK, JR., New York, N. Y. (Hughes Hubbard & Reed, John S. Allee, John W. Schwartz and Harold L. Kaplan, New York,

New York, on the brief), *for Plaintiff-Appellant Edward S. Redington, as Trustee for the liquidation of the business Weis Securities, Inc.*

CLARENCE FRIED, New York, N. Y. (Hawkins, Delafield & Wood, Philip R. Forlenza and Rafael Pastor, New York, N. Y., on the brief), *for Plaintiff-Appellant Securities Investor Protection Corporation.*

ARNOLD I. ROTH, New York, N. Y. (Rosenman Colin Freund Lewis & Cohen, Eugene Zemp DuBose, Jr. and Arthur S. Linker, New York, N. Y., on the brief), *for Defendant-Appellee.*

PAUL GONSON, Associate General Counsel; James H. Schropp, Assistant General Counsel; Theodore S. Bloch, Attorney, Securities and Exchange Commission, Washington, D. C., on the brief, *Amicus Curiae.*

LUMBARD, *Circuit Judge:*

In this appeal, rising out of the insolvency and liquidation of the brokerage firm of Weis Securities, Inc. ["Weis"], we are presented with the question whether a private cause of action exists under section 17 of the Securities Exchange Act of 1934[1] against account-

[1] 15 U.S.C. § 78q (1976). This section was amended in 1975; in 1972, the date relevant to the instant case, it read, in relevant part:

(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

ants who prepare misleading statements of a broker's financial affairs, and if so, who may maintain such an action.

The district court dismissed the claims herein of the Securities Investor Protection Corp. ["SIPC"][2] and of Edward S. Redington, Weis' Trustee in Liquidation ["Trustee"], believing that no claim for relief was stated because no cause of action could be implied from section 17.[3] *Redington* v. *Touche Ross & Co.*, 428 F. Supp. 483 (S.D.N.Y. 1977). We conclude that customers of a broker have a right of action against an accountant whose audits of the brokerage firm are false or misleading. Because we believe that SIPC and the Trustee are appropriate parties to seek (between them) total recovery of the customers' damages, we reverse and remand.

I

Touche Ross & Co. ["Touche Ross"] served as Weis' independent certified public accounting firm from 1969 to 1973. In that capacity, Touche Ross prepared annual audits of Weis' affairs as required by section 17 and regulations thereunder.

The complaint herein alleged that during fiscal 1972, certain of Weis' officers conceived and executed a scheme to conceal from the regulatory authorities and

[2]SIPC was created by the Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 91st Cong., 2d Sess., 84 Stat. 1636, *codified at* 15 U.S.C. §§ 78aaa-78*lll* (1976).

[3]Our decision in this case has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC. Judge Wyatt did not have the advantage of the SEC's position in this matter.

Judge Wyatt also dismissed, for lack of subject matter jurisdiction, five state common-law claims which the Trustee had sought to bring under principles of plenary bankruptcy or pendent jurisdiction, and four state common-law claims by SIPC, with respect to which diversity of citizenship had been alleged. Judge Wyatt ruled that SIPC was not a District of Columbia corporation for purposes of jurisdiction, and that complete diversity did not exist. Because of the view we take of the case, we need express no opinion as to the scope of bankruptcy jurisdiction in SIPA-receivership cases, nor as to the citizenship of SIPC.

the public Weis' dire financial condition.[4] The elements of this scheme appear in great detail in the complaint; for example, although Weis had suffered a loss for fiscal 1972 of greater than $1.5 million, its pre-tax earnings for that year were stated as being around $1.7 million.

When Weis' fiscal 1972 ended on May 26, 1972, Touche Ross proceeded to prepare and certify Weis' financial statements, and to answer the financial questionnaire required by the New York Stock Exchange of its member firms. In four opinion letters, dated July 7, July 7, July 21 and July 21 (all of 1972), Touche Ross represented that it had examined (i) the statement of Weis' current financial condition; (ii) Weis' answers to the financial questionnaire; (iii) Weis' consolidated balance sheet for the past year; and (iv) Weis' consolidated statement of earnings for the past five years, and found that each presented fairly and accurately the financial picture of Weis, in conformity with generally accepted accounting procedures.

In fact, Weis' financial condition was not as stated in the above four documents, but was far more precarious. As no steps were taken to attempt to remedy Weis' situation, it continued to deteriorate.[5] On May 24, 1973, the SEC sought an injunction preventing Weis and its officers from continuing to violate the '34 Act, and SIPC applied for a decree, pursuant to 15 U.S.C. § 78eee(a)(2), adjudging Weis' customers in need of protection under SIPA. Accordingly, Weis' liquidation was ordered by (then) District Judge Gurfein on May 30,

[4]In this posture of the case, we take—as we must—that view of the facts most favorable to plaintiffs, treating as true the allegations of the complaint. *See Escalera* v. *New York Housing Auth.*, 425 F.2d 853, 857 (2d Cir. 1970).

[5]Plaintiffs contend that the misleading statements certified by Touche Ross were the direct cause of the failure to take any remedial action, such as an infusion of capital or merger with another firm. Thus, they assert, Touche Ross' dereliction substantially contributed to Weis' forced liquidation and plaintiffs' losses. These contentions will be discussed more thoroughly in the body of the opinion.

1973, and Edward Redington was appointed Trustee for the liquidation.

SIPC and the Trustee jointly began an action against Touche Ross in New York state court on July 3, 1975. *Redington* v. *Touche Ross & Co.*, No. 13996/76 (Sup. Ct. N. Y. County). The common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the '34 Act were omitted. Five of the Trustee's six present "causes of action" appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims.

The instant suit was commenced on April 30, 1976. Under federal law and state common law, SIPC seeks to recover $14 million, either as subrogee of Weis' customers whose claims it has paid under SIPA, or as a member of the group directly injured by Touche Ross' delicts. Likewise under federal law and state common law, the Trustee is claiming $51 million; he contends that he may recover either by standing in the shoes of Weis' customers, since under SIPA, his is the responsibility to marshal and return their property,[6] or by standing in the shoes of Weis itself, since, he alleges, Weis—as an entity distinct from its conniving officers—was directly damaged by Touche Ross' unsatisfactory audit.

SIPC and the Trustee appeal from Judge Wyatt's order dismissing the complaint for failure to state a claim on which relief could be granted (with respect to the section 17 counts). Touche Ross asks us, in the event we reverse, to stay the federal action in favor of the state

[6]Property on hand when Weis was liquidated permitted the Trustee to return to customers 67% of the property they should have received. In addition, SIPC paid out some $14 million to customers and other creditors. Since under 15 U.S.C. § 78fff (1976), accounts are protected only up to $20,000 in cash and $50,000 in cash and securities, there may remain customers with uncompensated losses, who therefore retain claims against those who caused their losses. It is these claims that we hold the Trustee may assert. *See* part III B *infra*.

court suit.[7] This last issue, evidently, is one which Judge Wyatt has never had cause to consider.

II

The first question we address is whether customers of a brokerage firm are given any remedy by the '34 Act against accountants whose section 17 reports are false or misleading. There are two major considerations involved in this decision: the criteria laid down by the Supreme Court in *Cort* v. *Ash*, 422 U.S. 66 (1975), for finding an implied right of action in a statute which is silent on the issue; and the "purchase or sale" requirement reaffirmed by the Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

One preliminary matter must be dealt with. Judge Wyatt held that section 17 "was designed to supply administrative guidance in the bookkeeping area and not to create rights in anybody," and that it "does not impose any duty on accountants." 428 F. Supp. at 489, 491. We believe that, even if no right of action were implied, to see nothing but "administrative guidance" in a provision as crucial to the regulation of brokers as section 17 is to take far too narrow a view of the statute. Certified public accountants play a significant role in the scheme created by the '34 Act for the regulation of securities trading, as is recognized by the regulations promulgated by the SEC.[8] *See, e.g.*, 17 C.F.R. § 240.17a-5(b), (f), (g), (h), (i), (m). It is well established that section 10(b) of the '34 Act and rule 10b-5

[7]Plaintiffs aver that the state court action was commenced first only in a highly technical sense. It was begun by service of a summons without complaint (the complaint was not served until after the filing of the federal complaint), and then apparently ignored for some months by mutual consent. The parties agree that the state suit has progressed to the extent of responses by each plaintiff to one set of defendant's interrogatories.

[8]For a discussion of the functions and duties of accountants in this context, see *In re* Touche, Niven, Bailey & Smart, 37 S.E.C. 629, 5 Fed. Sec. L. Rep. (CCH ¶72,100, at 62,212 (1957); Note, *Accountants' Liability for False and Misleading Financial Statements*, 67 Colum. L. Rev. 1473 (1967).

thereunder impose a duty on accountants, for breach of which they may be sued. *See Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). We hold that section 17 of the '34 Act likewise imposes a duty on accountants.

A

The factors cited in *Cort* v. *Ash, supra,* 422 U.S. at 78, familiar through much repetition, which bear on the propriety of finding an implied right of action in a statute are:

> 1) Whether plaintiffs belong to the class for whose special benefit the statute was enacted;
>
> 2) Whether there is any indication of legislative intent on the issue;
>
> 3) Whether implication of a right of action is consistent with the policies behind the legislative scheme; and
>
> 4) Whether the cause of action in question is one traditionally relegated to state law.

A consideration of these four factors convinces us that implication of a right of action in favor of Weis' customers is appropriate.

1. The language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which Weis' customers are members of a class peculiarily protected by section 17.

The documents and reports that the SEC is empowered to require of brokers must be "necessary or appropriate in the public interest *or for the protection of investors*." 15 U.S.C. § 78q(a) (emphasis added). The

same is true of the examinations that the SEC is empowered to conduct. *Id.*[9]

In order to provide a complete and accurate picture of a broker's financial condition, the SEC requires that the broker enlist an independent accountant to audit and certify its statements, list any matters to which the accountant takes exception, and provide certain additional financial data. Rule 17a-5(b), (i) (k). Furthermore, a notice of any "material inadequacies" found by the accountant in the broker's procedures must be sent to the broker's customers. Rule 17a-5(m)(3).[10]

The function of this arsenal of financial reports is to protect the broker's customers. One of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325.

The net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its "principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers." Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967). As amended in order to take into account the creation of SIPC, the rule serves particularly to "protect customers prior to the time when the broker's . . . assets would be sufficient to satisfy customers in the event of liquida-

[9]In 1957, when the SEC expanded certification requirements for section 17 reports,

> that step represented the Commission's considered view that certification and reporting requirements constituted a valuable regulatory tool for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.

SEC, *Study of Unsafe and Unsound Practices of Brokers and Dealers,* H. Doc. No. 92-231, 92d Cong., 1st Sess., at 24 (1971).

[10]Citations to rule 17a-5 are to 17 C.F.R. § 240.17a-5 as it existed in 1972. Rule 17a-5(j)-(o) were adopted on June 30, 1972, and appear in the *Federal Register* for July 21, 1972.

tion." Exchange Act Release No. 11,497, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,212.

It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows.

2. We find no indication, either in the statute itself or in its legislative history, of any congressional intent either to create a private remedy under section 17 or to deny one.[11]

The legislative history of the section is mute on the issue, leading to the conclusion that Congress never *explicitly* considered the question. Nor can it be said that Congress *implicitly* chose to deny a private right of action; section 17 is distinctly different in an important respect from statutes as to which such implicit intent has been found.

In *SIPC* v. *Barbour*, 421 U.S. 412 (1975), the Supreme Court noted that SIPA manifested a specific legislative intent to restrict enforcement to the SEC. *Id.* at 420, 425. In *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974), a similar exclusivity was found to rest with the Attorney General; in *Cort* v. *Ash* itself, *supra*, 422 U.S. at 74-76, the Federal Election Commission was held to be the agency charged with exclusive enforcement.

We have recently indicated that an intent to commit enforcement of the securities statutes exclusively to the SEC will not readily be implied. *Abrahamson* v. *Fleschner*, 568 F.2d 862, 874 n.19 (2d Cir. 1977).

[11]To the extent that the court below relied on the remedy created by section 18 of the '34 Act as evidence of a legislative intent to deny a private remedy for violations of section 17, its concerns will be treated in part II B *infra*.

Nothing in section 17 induces us to treat it as an exception to this rule.

3. "Absent specific statements of legislative intent, we must examine the legislative purposes underlying the Act." *Abrahamson* v. *Fleschner, supra*, 568 F.2d at 874, conclude that a private right of action under section 17 is consistent with those purposes.

A partial list of the many sections of the securities acts under which private remedies have been implied appears in *Franklin National Bank* v. *L. B. Meadows & Co.*, 318 F. Supp. 1339, 1341-42 (E.D.N.Y. 1970). *See* III L. Loss, Securities Regulation 1785 (2d ed. 1961). At least since *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (section 14(a)), it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons; those persons may sue for the 'statutory tort' committed when the duty is breached.

We have held that section 17 imposes a duty on accountants in favor of brokers' customers. We note that—just as in *Borak*—the SEC was not meant to, and does not have the resources to examine and audit all the documents that it receives (in *Borak*, proxy statements; here, section 17 reports).[12] Both it and SIPC, as well as the broker's customers must rely on the certification by the accountants.

Neither SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost. Indeed, the cases cited by Judge Wyatt in support of the proposition that there exists injunctive and criminal relief for violations of section 17 do not involve

[12]In its *amicus* brief, the SEC advises us that, in fiscal 1976, over 5000 brokers and dealers were registered with it; that each of the approximately 750 broker-dealers that are not members of self-regulating organizations must be audited annually, as must the 500 or so against whom complaints are lodged; and that this leaves the SEC able to examine each year the statements of only 5% of broker-dealers who are apparently untroubled members of self-regulatory organizations.

accountants. *See* 428 F. Supp. at 490, and cases cited. Accordingly, we rule that a private remedy is an essential supplement to the scheme of enforcement of section 17.

4. Finally, it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting. Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' customers varies widely. There is no reason to believe that the remedy sought herein is one traditionally relegated to state law.

B

The court below found a particularly high barrier to plaintiffs in section 18 and the judicially created purchaser-seller doctrine. 428 F. Supp. at 489-90. Section 18 creates private remedy for "misleading statements" in "any application, report, or document filed pursuant to this chapter," in favor of "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . ." 15 U.S.C. § 78r.

Applying this language, and the holding of *Blue Chip Stamps, supra,* 421 U.S. at 736, Judge Wyatt ruled that the remedy provided by section 18 was exclusive, and that thus no remedy existed for brokers' customers injured as a result of an accountant's misleading statements, absent a purchase or sale of an affected security. We disagree.

Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.

Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced *not* to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se.

III

In light of the foregoing analysis, we decide that brokers' customers have a right of action against accountants for certifications that violate the standard set by section 17 and rule 17a-5. This does not, however, resolve the question whether the plaintiffs in the instant case, SIPC and the Trustee, are proper parties to bring the action.

A

SIPC asserts a right to bring this action both in its own right and as subrogee of the customers whose claims it has paid. We hold that SIPC may maintain the action as subrogee.[13]

SIPA provides expressly that SIPC, upon reimbursing a customer's losses, shall be subrogated to that customer's claims against the debtor's (here Weis')

[13]We need not reach the question whether SIPC could ever have a claim for damages other than on behalf of a broker's customers; we only note that as the creature of a 1970 statute, SIPC can hardly claim to have been a specially protected beneficiary of the '34 Act. SIPC makes much of 15 U.S.C. § 78bbb (1976), which treats SIPA as if it "constituted an amendment to, and was included as a section of" the '34 Act. Nonetheless, it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or in 1970; the cited portion of the 1970 statute appears to do no more than indicate that, except where specifically provided otherwise, any remedy created by SIPA is supplemental to the preexisting remedies of the '34 Act.

estate. 15 U.S.C. § 78fff(f)(1). Touche Ross contends that SIPC's statutory right of subrogation against the debtor's estate is its exclusive remedy, precluding any rights against third parties such as Touche Ross. We disagree.

Section 78fff is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section. However, there is no reason to believe that this was meant to destroy SIPC's general common-law right of equitable subrogation.

> [T]he general rule is that upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss.

31 N.Y. Jur., *Insurance* § 1620, at 510. *See Ackerman* v. *Motor Vehicle Accident Indemnification Corp.*, 18 App. Div. 2d 307, 239 N.Y.S.2d 463 (1st Dept. 1963) (explicit statutory provision did not destroy MVAIC's broader common-law right to subrogation).

Moreover, we believe that it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers. Accordingly, we find that SIPC is subrogated to the right of action implied in section 17 in favor of brokers' customers against third parties such as accountants. *See SEC* v. *Albert Maguire Securities Co.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,129, at 92,076 (3d Cir. July 27, 1977).

B

The Trustee contends that he is a proper plaintiff herein, both as the representative of Weis' estate and as bailee of Weis' customers' property. We hold that he may maintain this action on behalf of such customers as have not been fully reimbursed by SIPC.

The barriers to a right of action on Weis' behalf are insurmountable. It is apparent that brokers, such as Weis, were not included in the class of those *protected* by section 17; indeed, brokers are the very entities *regulated* by section 17.

Two recent cases in point are *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), and *Lank* v. *New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977). In each, a member of the class sought to be regulated by Congress attempted to claim the benefit of an implied right of action under the very statute that regulated it. *Chris-Craft* held that a defeated tender offeror could not enforce the Williams Act, 15 U.S.C. § 78o(e), against a successful tender offeror, because "a party whose . . . conduct was purposefully brought under federal control by the statute . . . can scarcely lay claim to the status of 'beneficiary' whom Congress considered in need of protection." 430 U.S. at 37.

In *Lank*, we decided, in a case not unlike the instant case, that the receiver of a liquidated brokerage firm could not—because the firm itself could not—sue a securities exchange for failure to force the firm to comply with the exchange's rules. We pointed out that the '34 Act did not afford protection "to the very members of the stock exchanges whose conduct was being regulated." 548 F.2d at 66. The extent to which *Lank* parallels the instant case precludes our holding that the Trustee may maintain this action on Weis' behalf.

However, none of the above considerations apply to an action brought by the Trustee as bailee of the property of Weis' customers. He is responsible for marshalling and returning their property; to the extent that he is unable to do so, he argues, he may sue on behalf of the customer/bailors any wrongdoer whom they could sue themselves.

Rule 17(a) of the Federal Rules of Civil Procedure reads, in part: "[A] . . . bailee . . . may sue in his own name without joining with him the party for whose

benefit the action is brought. . . ." The Advisory Committee Notes to this section, added in 1966,[14] point out by way of illustration that the "owner of a warehouse in which household furniture is stored is equally entitled to sue on behalf of the numerous owners of the furniture stored." 39 F.R.D. 69, 85 (1966). *See generally* 5 N.Y.Jur., *Bailments* §§ 118, 119.

To the extent that customers have claims that have not been satisfied either by Weis in liquidation, *see* note 6 *supra,* or by SIPC, they retain rights of action against Touche Ross. We hold that the Trustee, as bailee, is an appropriate real party in interest to maintain this action on their behalf.

IV

Since we hold that both SIPC and the Trustee may maintain this action against Touche Ross, we remand to the district court for further proceedings consistent with this opinion. We leave to it in the first instance a number of questions that will now arise: whether to stay the federal action pending determination of the state action;[15] whether to exercise pendent jurisdiction over the plaintiffs' common-law claims; and what the appropriate standard is for accountant liability in actions under section 17, *cf. Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

Reversed and remanded.

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[14]The purpose of the 1966 amendment was "[to] add to the illustrative list of real parties in interest a bailee—meaning, of course, a bailee suing on behalf of the bailor with respect to the property bailed." 39 F.R.D. 69, 84 (1966).

[15]In *Weiner* v. *Shearson, Hammill & Co.,* 521 F.2d 817 (9th Cir. 1975), the court of appeals chose to remand the question of a stay to the district court, despite its thorough discussion of the factors involved in the determination of the question.

TIMBERS, *Circuit Judge,* concurring:

I concur in all respects in Judge Lumbard's clear, concise and, in my view, correct majority opinion.

In view of the characteristically thoughtful and earnest dissent of our Brother Mulligan, however, I should like to add a few words, partly to supplement Judge Lumbard's opinion, but chiefly to suggest that Judge Mulligan's dissent be read in the light of the following observations.

First, in urging that customers of a broker-dealer in liquidation have no implied right of action for damages under Section 17 of the Exchange Act against accountants who prepare false or misleading reports required by that statute, the dissent understandably is disturbed by the *unanimous* opinion in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), as recently reaffirmed in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 37-45 (1977). Granted that the dissent's massive effort to distinguish or to apply a gloss to *Ash* is an artful attempt to circumvent this key decision, I fear that our dissenting colleague has misapprehended the essential purpose of *Ash* in stating certain factors to be taken into consideration in determining whether to imply a right of action under a given statute. The dissent at the outset, *post,* at , emphasizes that *Ash* is not relevant to a case which arises under a statute which expressly provides for a private right of action. This overlooks the fact that the Supreme Court specifically applied the *Ash* analysis in *Piper, supra,* 430 U.S. at 37-41, in determining whether a private remedy was implicit in Section 14(e) of the same statute with which we are here concerned, i.e. the Exchange Act. Assuming that what the dissent intends to emphasize, *post,* at , is that *Ash* does not apply when an *express remedy* is provided for the *specific wrong* complained of, it must be remembered that the Court reaffirmed the implication of a private right of action under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated

thereunder in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975), despite the absence of legislative history on the subject, *id.* at 737, much less "clear contrary evidence of legislative intent." *Post*, at .

Second, the dissent's displeasure with *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), likewise is understandable. This seminal opinion written by the late Mr. Justice Tom Clark for a *unanimous* Supreme Court, in holding that Section 27 of the Exchange Act provided the jurisdictional underpinning for an implied private right of action for damages (as well as for declaratory and equitable relief) arising from violations of Section 14(a) of the Exchange Act, *id.* at 430-35, expressly recognized that "Private enforcement of [Commission rules] provides a necessary supplement to Commission action", *id.* at 432, and, that "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Id.* at 433. Despite our Brother Mulligan's herculean effort in dissent to buttress his assertion that *Borak* "has been significantly restricted by more recent decisions of the Supreme Court", *post*, at , those decisions strike me as expressly and emphatically reaffirming the *Borak* rule[1]—as Mr. Justice Stevens stated in *Piper, supra*, 430 U.S. at 67, "*Borak* remains a viable precedent."

Third, the dissent speaks disparagingly of the SEC amicus brief. *Post*, at 2725 n.1. As Judge Lumbard correctly points out, *ante*, at 2707 n.3, we were aided materially by the SEC brief, whereas the district court did not have the advantage of knowing of the SEC's position. Here again, our Brother Mulligan's attempt to disparage the SEC brief is understandable, for it urges forcefully and cogently that SIPC should be permitted to assert a private right of action under Section 17 of the

[1]For example, in *Piper, supra*, 430 U.S. at 25, Chief Justice Burger stated:

> "This Court has nonetheless held that in some circumstances a private cause of action can be implied with respect to the 1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (§14(a)); *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n. 9 (1971) (§10(b))."

In *SIPC* v. *Barbour*, 421 U.S. 412, 417 (1975), referring to *Borak*, Mr. Justice Marshall summarized its holding:

> "In light of the 'broad remedial purposes' of the Act and the SEC's representation that private enforcement was necessary to effectuate those purposes, the Court held that the action for damages could be maintained."

And in *Blue Chip Stamps, supra*, 421 U.S. at 730, after summarizing the 25 year development of the decisional law that there is an implied private right of action under Rule 10b-5, Mr. Justice Rehnquist, referred to *Borak* as follows:

> "Such a conclusion was, of course, entirely consistent with the Court's recognition in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964), that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'"

These decisions do not strike me as significantly "restricting" *Borak;* rather, they seem quite clearly to reaffirm *Borak* as a "viable precedent", each case turning of course on the particular statute or rule under consideration.

Exchange Act under the circumstances of this case. But far more basic than whether the SEC as amicus supports or opposes one side or the other in litigation under the federal securities laws, *is that the position of the SEC should be known to the court.* That is the point of Judge Lumbard's observation referred to above. And it is especially important in a case of first impression such as the instant one involving a statute under which Congress has imposed on the Commission specific responsibilities.[2] Wholly aside from the instant case—where I find the

[2]Section 7 of SIPA, 15 U.S.C. §78ggg (1976). See *SIPC* v. *Barbour, supra*, 421 U.S. at 417.

The SEC cogently summarizes in its brief filed in our Court its interest in the instant appeal as follows:

> "The Commission respectfully submits this brief as *amicus curiae* because this appeal raises significant issues which could materially affect its administration of the federal securities laws. We believe . . . that permitting a private right of action under Section 17 of the Securities Exchange Act will provide a necessary supplement to the Commission's efforts to enforce that section and the rules and regulations thereunder. In addition, financial statements submitted by broker-dealers

SEC amicus brief to measure up to the Commission's high standard of competence and fairness—I do hope that our Brother Mulligan's disparagement of the SEC amicus brief will not be construed as a judicial signal, even in dissent, that the Commission should retreat to its position of a generation ago which drew sharp criticism from our Court. *Compare Blau* v. *Mission Corp.*, 212 F.2d 77, 81 (2 Cir.), *cert. denied*, 347 U.S. 1016 (1954), and *Roberts* v. *Eaton*, 212 F.2d 82, 84 (2 Cir.), *cert. denied*, 348 U.S. 827 (1954), *with Studebaker* v. *Gittlin*, 360 F.2d 692, 695 (2 Cir. 1966), and *Greene* v. *Dietz*, 247 F.2d 689, 695-98 (2 Cir. 1957) (concurring and dissenting opinions; per curiam opinion on rehearing). *See Some Practical Aspects: The SEC and The Federal Judiciary*, 41 A.B.A.J. 1136, 1137-38 (1955).[3]

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pursuant to the Act play a key role in the Commission's administration and enforcement of various statutory provisions designed to protect against loss of the funds and securities of customers of broker-dealers and to maintain confidence in the securities markets at a high level. The availability of a right of action under Section 17 will thus have a direct bearing on the overall effectiveness of such statutory and regulatory provisions as those regarding hypothecation and segregation of securities and cash, and the net capital rule, designed to ensure the ability of brokers to meet their financial obligations as custodians of customer property. In addition, the Commission has 'plenary authority' with respect to the operations of the Securties Investor Protection Corporation, and is therefore concerned that SIPC have the ability to recover funds needlessly expended due to the wrongful acts of others, thus preserving the funds available to compensate losses suffered by the customers of brokers." (footnotes omitted). SEC Amicus Curiae Brief, filed August 31, 1977, at 3-4.

[3]I am pleased to note that, in response to my concurring opinion, Judge Mulligan very commendably has disclaimed any intention to disparage the SEC amicus brief below, n.1, last paragraph. This reflects the good judgment and fairness for which our distinguished colleague is well known. As a former Dean of the Fordham Law School, I think that Judge Mulligan would join in taking judicial notice of one of the leading expositions of the history and functions of the amicus curiae through centuries of development of the law. Beckwith and Sobernheim, Amicus Curiae—MINISTER OF JUSTICE. 17 Fordham Law Review 38 (1948).

Accordingly, after carefully considering Judge Mulligan's dissenting opinion, especially in the light of the observations set forth above, I concur without qualification in Judge Lumbard's majority opinion.

MULLIGAN, *Circuit Judge* (dissenting):

In my view this case was properly decided by Judge Wyatt and the order and judgment dismissing the complaint should be affirmed.[1] The majority announces that "[a]t least since *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) . . . it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons, those persons may sue for the 'statutory tort' committed when the duty is breached." Majority opinion at 2715. The *Borak* rule, which liberally implied private actions in federal regulatory acts on a statutory tort theory, has been significantly restricted by more recent decisions of the Supreme Court which are misapplied by the majority opinion.[2]

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[1]The majority comments in footnote 3 that its decision has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC and that Judge Wyatt did not have the advantage of the SEC's position in this matter. The Supreme Court, however, in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1. 41 n.27 (1977) observed that ". . . its [the SEC's] 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants." That, of course, is the principal issue in this case as well. It should also be added that a substantial part of the SEC brief is devoted to the argument that SIPC in its own right may assert a private right of action for violations of section 17 of the '34 Act. This proposition was not only rejected below but was repudiated by the majority in its footnote 13.

I do not "disparage", as my Brother Timbers would have it, the brief of the SEC. I simply do not agree with it—neither does the majority, at least to the extent I have indicated. Nor do I dispute the propriety of its submission. I cannot believe that disagreement with the opinions of any agency can sensibly discourage the filing of a brief expressing its views as *amicus curiae (sed non parens curiae)*. It remains the function of the bench to construe the law as best it can even though that involves on occasion disagreement with one's colleagues or even an agency.

[2]These decisions discussed in the text, *infra*, include *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), *Cort* v. *Ash*, 422

While the majority purports to consider the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975), it must be emphasized that Justice Brennan in his opinion in *Cort* carefully restricted their application: "In determining whether a private remedy is implicit in a statute *not expressly providing one*, several factors are relevant." 422 U.S. at 78 (emphasis supplied). In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 37 (1977) Chief Justice Burger's opinion similarly confined the *Cort* factors, noting that they are " 'relevant' in determining whether a private remedy is implicit in a statute *not expressly providing one*." (Emphasis supplied).

In the instant case, however, we are confronted with a statute for which Congress has clearly provided a remedy in the event of certain violations. Admittedly, section 17(a), set forth in footnote 1 of the majority opinion, does not itself include any private remedy for an infraction of its terms. It simply requires that brokers or dealers such as Weis, make, keep and preserve records and make such reports as the SEC may prescribe by its rules and regulations in the interest of the public and for the protection of investors. Other comparable sections of the '34 Act (the Act) also provide for the filing of reports. See sections 13(a), 15 U.S.C.§ 78m(a); 13(d), 15 U.S.C.§ 78m(d); 13(f), 15 U.S.C. § 78m(f); and 15

U.S. 66 (1975); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) *(Amtrak)*; see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). Numerous commentators have acknowledged the substantial retreat from *Borak* represented by these subsequent Supreme Court rulings. E.g., Climan, Civil Liability Under the Credit-Regulation Provisions of the Securities Exchange Act of 1934, 63 Cornell L. Rev. 206, 261-69 (1978); Comment, Implying Private Causes of Action From Federal Statutes: *Amtrak* and *Cort* Apply the Brakes, 17 B.C. Ind. & Com. L. Rev. 53, 64 (1975); Comment, Private Rights of Action Under *Amtrak* and *Ash:* Some Implications for Implication, 123 U. Pa. L. Rev. 1392, 1416 (1975); Note, Implication of Private Actions from Federal Statutes: From *Borak* to *Ash*, 1 J. Corp. Law 371 (1976); 30 Vand. L. Rev. 905, 908-10 (1977).

(a), 15 U.S.C. § 78o(d). Like section 17(a), these sections include in their text no provisions for a private remedy.

Section 17 is immediately followed, however, by section 18(a), 15 U.S.C. § 78r(a), entitled "Liability for Misleading Statements" which does provide an express private remedy for violation of the reporting provisions of the Act. It states:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the '34 Act] or any rule or regulation thereunder . . . , which statement was . . . false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have *purchased or sold a security* at a price which was affected by such statement, for damages caused by such reliance unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading.

(Emphasis supplied).

Section 18(a) follows upon the heels of section 17. Its subject matter covers reports or documents filed pursuant to the '34 Act and regulations promulgated thereunder. Thus, Judge Wyatt correctly found and, indeed, common sense would dictate, that section 18(a) expressly provides the sole private remedy which Congress intended to be available for a violation of section 17(a) and the other reporting sections of the '34 Act. Furthermore, most courts which have considered the issue have found section 18(a) to contain the only remedy for violation of the Act's reporting sections.[3]

[3] *Meer* v. *United Brands Co.*,[1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶95,648 at p. 90,213 (S.D.N.Y. 1976); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1340 (E.D. Pa. 1972),

It seems clear, then, that the statutory scheme enacted by Congress provides in section 18(a) an express but limited remedy for violations of section 17(a). As noted above, the Supreme Court has repeatedly limited use of the *Cort* factors to instances in which *no* statutory remedy whatsoever has been provided. Hence, it must seriously be questioned whether the *Cort* factors are even the appropriate analytical tool to determine whether an implied private right of action should exist for infractions of section 17(a). Nonetheless, using a *Cort* analysis the majority finds an implied private damage remedy because it determines that brokers' customers are "favored wards" of, and a class "peculiarly protected" by section 17. Therefore, states the majority, we cannot assume that the Congress intended to deprive them of "the means of protection." Majority opinion at 2716.

I believe the majority reasoning is faulty in two major respects. In the first place, if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers.

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relevant point adhered to on reargument, 357 F.Supp. 869 (E.D. Pa. 1973), aff'd, 494 F.2d 528, 539-40 (3d Cir. 1974); see *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213, 214 (S.D.N.Y. 1975), aff'd without opinion, 538 F.2d 312 (2d Cir. 1976). But see the district court cases discussed in *In re Penn Central Securities Litigation, supra,* 494 F.2d at 540 n.18.

It should be noted that in a case related to that at bar the customers of Weis brought a class action against Touche Ross alleging, *inter alia,* that Touche Ross' certification of the same financial statements involved here was in violation of Rule 17a-5, 17 C.F.R. § 240.17a-5 and gave the customers a cause of action under section 18(a). *Rich* v. *Touche Ross & Co.*, 415 F.Supp. 95, 101-02 (S.D.N.Y. 1976). Judge Brieant dismissed the complaint, finding that since the plaintiffs did not meet the purchaser-seller requirements of 18(a) they stated no claim for the alleged violation of Rule 17a-5. Id. at 102-04.

The principle of statutory construction by which one reaches this result is somewhat forbiddingly known as *"expressio unius est exclusio alterius"*. This maxim was recently emphasized and applied by the Supreme Court in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) (*Amtrak*). There the Court held that the plaintiff association of railroad passengers had no implied cause of action as primary beneficiaries of the Rail Passenger Service Act of 1970 since that Act expressly provided for enforcement by the Justice Department. In its opinion, the Court observed:

> A frequently stated principle of statutory construction is that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.". . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.* Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created are the exclusive means to enforce the duties and obligations imposed by the Act.

414 U.S. at 458.

Soon after its decision in *Amtrak* the Supreme Court reaffirmed its reliance on the *expressio unius* principle in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412, 418-19 (1975). In finding that the express statutory grant to the SEC of a right to seek injunctive relief to enforce duties under the Securities Investor Protection Act precluded an implied right in others to seek similar relief, the Court reiterated its observation in *Amtrak* that "express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature." Id. at 419.

Similarly, in the instant case the provision by Congress in section 18(a) of a narrow private cause of action for section 17(a) infractions militates strongly against our attributing to Congress a willingness to allow more expensive enforcement of the duties and obligations created by that section. Moreover, while the Court in *Amtrak* acknowledged that the *expressio unius* principle must "yield to clear contrary evidence of legislative intent," 414 U.S. at 458, the majority here concedes that it finds nothing in the language or legislative history of section 17(a) to indicate that Congress intended to create a private cause of action under that section. In my view appellants have failed to demonstrate the "clear contrary evidence" to rebut the conclusion that the limited express right of action under section 18(a) is the exclusive remedy for a breach of section 17(a).[4]

We find further support for the position that there is no private right of action implied under section 17(a) in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). There the Court commented: "When Congress wished to provide a remedy [under the '34 Act] to those who neither purchase nor sell securities, it had little

[4] I do not overlook Judge Timbers' recent opinion in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), petition for cert. filed, 46 U.S.L.W. 3588 (U.S. March 21, 1978) (No. 77-1279), which the majority cites to distinguish *Amtrak* and *Barbour* on the ground that those cases did not involve implication of private actions under the securities acts. It is important to note that in *Abrahamson*, where the court found a private right of action for damages implied for violations of section 206 of the Investment Advisers Act, 15 U.S.C. §80b-6, Judge Timbers, in his opinion for the majority, repeatedly stressed that the Investment Advisers Act made *absolutely no provision* for express private actions. Id. at 872, 874, 875. The opinion in *Abrahamson* contrasts this omission to those other securities acts which contain "sections *expressly* granting injured parties a private action for damages." Id. at 874 (emphasis in original); see *Piper* v. *Chris-Craft Industries, Inc.*, *supra*, at 24-25. Indeed, in this connection the opinion then refers specifically to section 18 of the '34 Act. Id. at 874 n.20. Judge Timbers concluded: "Had Congress provided explicitly for private damage actions it would be unnecessary to consider whether the remedy should be judicially implied." Id. at 875. This conclusion in *Abrahamson* is in fact strongly supportive of the analysis in this dissent.

trouble in doing so expressly" 421 U.S. at 734. Judge Wyatt's opinion below reviews several such sections of the '34 Act which impose liability on persons other than purchasers or sellers. 428 F.Supp. at 490. The presence of these provisions in the '34 Act reinforces the conclusion that the framing of the section 18(a) remedy in terms of purchasers and sellers of securities to the exclusion of customers of broker-dealers was an intentional congressional limitation on the class for whom a private action would be available in the event of a section 17(a) violation.

The Supreme Court in *Blue Chip* also addressed itself specifically to section 18:

> Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . . It would indeed be anomalous to impute to Congess an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.

421 U.S. at 736.

But that is precisely what the majority is imputing to Congress in this case. The misleading reports which create the basis for the claim here made were required to be filed by section 17(a) of the '34 Act and the remedy provided by section 18(a) concedely encompasses not broker-dealer customers but only securities purchasers or sellers.[5] I find that *Amtrak*, *Barbour* and *Blue Chip*

[5] It should be noted that in another suit arising out of the Weis debacle Judge Wyatt has sustained a section 18(a) claim asserted by a plaintiff bank which allegedly purchased securities of Weis in reliance on the section 17(a) reports involved in this case. *Exchange National Bank* v. *Touche Ross & Co.*, 75 Civ. 916 (S.D.N.Y.).

compel the conclusion that the omission was studied and that the implication of a damage action against accountants under this section is totally unwarranted. The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy provided was designed to exclude the class which is here seeking monetary relief. Thus, the majority's holding in my view goes beyond statutory construction; it amounts instead to judicial legislation.

II

The second flaw in the majority opinion is the failure to consider the impact of *Piper* v. *Chris-Craft Industries, Inc., supra,* in its discussion of the *Cort* factors. In *Piper* the Court, while again carefully limiting its holding to cases where the statute to be construed provides no private remedy, id. at 24-25, emphasized that private relief will be implied in favor of a particular class intended to be protected by the statute only when it is " 'necessary' " to effectuate Congress' goals. 430 U.S. at 25.[6] The inquiry called for is to ascertain the congressional purpose and to determine whether a private damage action by brokers' customers is a *necessary* adjunct, id., to accomplish the primary congressional goal embodied by the legislation. *Cort* v. *Ash, supra,* at 84.

The plain language of section 17 establishes the congressional concern that the SEC be kept on notice of the financial health and stability of registered broker-dealers through whom public investors purchase and sell securities.

[6]The underscoring of the element of necessity three times in the *Piper* opinion, 430 U.S. at 25, indicates the emphasis the Court wished to bring to this factor in determining whether a private remedy should be implied. *Piper,* therefore, is not simply a restatement or affirmation of *Cort* but adds a significant gloss. *Wilson* v. *First Houston Investment Corp.,* 556 F.2d 1235, 1239, 1240 (5th Cir. 1978).

The SEC itself has long recognized that the primary protection for brokers' customers lies in preventive monitoring: "customers do not open accounts with a broker relying on suit, judgment and execution to collect their claim—they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." *Guy D. Marianette,* 11 SEC 967, 971 (1942). Hence, the broker-dealer is required to file reports which are subject to such examination as the SEC may deem necessary or appropriate in the public interest or for the protection of investors. As the majority points out, a principal and, in fact, dominant method of investor protection is the net capital rule. Section 15(c)(3) of the '34 Act, 15 U.S.C. § 78o(c)(3), authorizes the SEC to provide safeguards with respect to the financial responsibility of broker-dealers including their "acceptance of custody and use of customers' securities, and the carrying and use of customers' deposits or credit balances." Pursuant to Rule 15c(3)(1)(b)(2), 17 C.F.R. § 240.15c3-1(b)(2), the SEC exempts broker-dealers who are members in good standing of the New York Stock Exchange (as was Weis) from compliance with SEC net capital requirements. This is because such broker-dealers are subject to Exchange Rule 325, which is deemed by the Commission to impose requirements more comprehensive than the requirements of the SEC. Id. Under Rule 325 Weis was required to maintain a minimum prescribed ratio of aggregate indebtedness to net capital. Compliance by broker-dealers with the net capital rule is ensured by the filing of reports and monitoring by SEC as well as by the Exchange, which is authorized to enforce its regulations, see 15 U.S.C. § 78(f) and which, according to the SEC brief submitted on this appeal, makes annual examinations of each of its broker-dealer members to this end.

Congressional concern for the solvency of broker-dealers was not limited to the reporting and monitoring requirements of section 17. Following the boom of the

1960's a number of brokerage firms experienced financial instability and even failure. *Securities Investor Protection Corp.* v. *Barbour, supra,* at 415. The response of Congress was the enactment in 1970 of the Securities Investor Protection Act (SIPA), 15 U.S.C. §78aaa *et seq.* as an amendment to the '34 Act. Under SIPA Congress created the Securities Investor Protection Corporation (SIPC), the function of which extends well beyond providing protection to investors upon the liquidation of their brokers. As the Court noted in *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421:

> The SIPC properly treats an application for the appointment of a receiver and liquidation of a brokerage firm as a last resort. It maintains an early-warning system and monitors the affairs of any firm that it is given reason to believe may be in danger of failure.

The SEC too has noted that the primary purpose of the net capital requirements for broker-dealers is to give "the [SEC], self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time . . . of liquidation." 1934 Act Release No. 11497, June 26, 1975 [1975-76 Transfer Binder], CCH Fed. Sec. L. Rep. ¶80,212.

The majority here finds that since section 18(a) leaves broker-dealer customers without protection and since brokers' customers are the "favored wards" of section 17, it cannot agree that Congress simultaneously sought to protect them and to deprive the class of the means of protection. However, a review of section 17(a) and the rules promulgated by the SEC as well as the creation of SIPC, demonstrates that the means Congress employed to ensure solvency of broker-dealers were to require the keeping and filing of records, the maintenance of certain net capital balances and the oversight of

the SEC, SIPC and the Exchanges. Thus, the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers; not to create private law suits for damages *after* insolvency has occurred.[7]

Since the filing requirements of section 17(a) are designed to give early warning, the importance to this scheme of implying a damage remedy *after* liquidation is dubious. Congress made no suggestion either in 1934 or in 1970, when it enacted SIPA, that a private damage action was a *necessary* corollary of the section 17(a) reporting provisions. The threat of liquidation under SIPA as well as the criminal sanctions available for violations of section 17(a) certainly present a greater deterrent than private damage actions.[8] As the Supreme Court noted in *Piper,* "Nor can we agree that an ever-present threat of damages [beyond available injunctive relief] . . . will provide significant additional protection. . . . The deterrent value, if any, of such awards can never be ascertained with precision." 430 U.S. at 39-40.

Even more importantly, to the extent that a threat of private damage actions might further induce compliance with the reporting scheme of section 17 the majority has discounted the effect of available state law remedies, which arise not from state securities law protection of brokers' customers, but from well established tort law

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[7]In fact SIPC's preventive measures have been quite successful. The vast majority of firms brought to SIPC's attention have been deterred from the necessity of undergoing a SIPC liquidation through a variety of tactics including mergers and withdrawal from the business of carrying customer accounts. See *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421 n.4.

[8]For example, in the instant situation the SEC initiated an action for injunctive relief against Weis and its officers. *SEC* v. *Weis Securities, Inc.,* 73 Civ. 2332 (S.D.N.Y.). A number of Weis' principals were also convicted of a criminal conspiracy to falsify Weis' books of account. See *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.

principles.[9] See, e.g., Restatement 2d of Torts §§ 531,552 (1977). Common law actions for damages against accountants have long been recognized. See, e.g., Note, Accountants' Liabilities For False and Misleading Financial Statements, 67 Colum. L. Rev. 1437 (1967). Where, as in the instant case, fraud is arguably alleged, it is important to note that should the actionable elements of fraud be provable, the states have universally permitted recovery to third parties who relied on the misrepresentations. Anno.: Liability of Public Accountant to Third Parties, 46 A.L.R. 3d 979, 982-83 (1972). While the state law treatment of actions based only on an accountant's negligence has not been so uniform, id. at 982, the trend in state law, based on generally recognized tort principles, has been to expand the accountant's liability for negligence to those clearly definable classes of third parties who the accountant knew would rely on the statements in question. See, e.g., *White* v. *Guarente,* 43 N.Y.2d 356, 401 N.Y.S.2d 474 (1977); Restatements 2d of Torts § 552 (1977). In fact, should scienter be held a required element of the action found implied by the majority in section 17,[10] see *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), it may well be that a state law action would provide a broader basis for accountant liability than the federal action implied here under the '34 Act.

In any event, the very existence of these state law remedies supplies that threat of liability which the majority essentially is seeking in order to promote adherence to the requirements under section 17(a).

[9]The same cannot be said of the appellants herein. In addition to the state law class action against Touche Ross which has been filed by Weis' customers in the Supreme Court of New York County, see *Rich v. Touche Ross & Co., supra,* 415 F.Supp. at 104, the appellants have initiated a state law action based on the same common law claims set forth in their complaint in this federal action. *Redington* v. *Touche Ross & Co.,* No. 13996/76 (Sup. Ct. N.Y. Co.).

[10]The point was reached neither by the majority here nor by Judge Wyatt below.

Thus, the majority wrongly dismisses the significance of availiable state law remedies on the ground that the standard of liability for private damage actions in connection with 17(a) violations must be national in scope. Since, as demonstrated above, the *primary* congressional purpose underlying the section 17 reporting scheme is prophylactic, uniformity of standards for actions brought to recover losses *after* the brokerage firm has failed simply is not *necessary* to achieving the primary goals of that statute. See *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 477-78 (1977).

The SEC has also argued, and the majority has accepted the position, that private damage actions are a necessary supplement to commission action because the SEC does not have the resources to audit the financial statements submitted under section 17(a). Whatever force this argument might once have had, see *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432, is seriously undermined by the Court's observation in *Piper* that "institutional limitations alone do not lead to the conclusion that any party . . . should have a cause of action for damages." 430 U.S. at 41. The argument that a regulatory agency is confessedly unable properly to regulate broker-dealers as charged by Congress and detailed by its own regulations, and that therefore the federal courts should find a damage remedy implicit in an act which studiously avoided giving one to the class sought to be represented here, is simply unpersuasive.[11]

In sum, I conclude that since section 18(a) of the Act does provide a damage remedy for the filing of misleading statements in section 17(a) reports, and since this remedy excludes from its coverage the customers of

[11]The problem faced by the SEC in *Borak* of examining proxy statements under demanding time limitations (10 days or even 2 days, 17 C.F.R. §§ 240.14a-6(a), (b)), as pointed out by Judge Wyatt, 428 F. Supp. at 491, is not encountered here. Moreover, the SEC itself has stated that its burdens in this connection are lightened by the Exchange, which makes annual examinations of net capital statements by its members.

broker-dealers, the *Cort* factors employed by the majority afford an inappropriate analytical framework for this case. Instead, under the reasoning of *Amtrak* and *Barbour* it is apparent that by limiting actions under section 18(a) to purchasers and sellers of securities Congress expressed its intent to deny recovery for section 17(a) violations to a broader class of plaintiffs. Nor have the appellants here adduced the strong contrary evidence of legislative intent regarding section 17(a) which would lead me to reach the conclusion, embraced by the majority, that implication of such a remedy is consistent with the legislative scheme. Moreover, even if the *Cort* factors were the proper mode of analysis in this case, they must be applied in conjunction with the gloss of *Piper*. Yet there is no showing here that a private damage remedy against accountants is *necessary* to vindicate the primary congressional purpose embodied in section 17(a). As Judge Medina observed in *Lank* v. *New York Stock Exchange*, 548 F.2d 61, 65 (2d Cir. 1977) where we refused to imply a private remedy in favor of the SIPC receiver of an insolvent broker-dealer against the Exchange: "Even were we to agree . . . that granting him a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place."

III

Having found no implied cause of action arising under section 17(a) in favor of customers of broker-dealers, I could of course find no derivative rights in either SIPC or the trustee. However, I also contest the holding that appellants are proper parties to maintain the action found by the majority to be implied in section 17(a). The majority has properly held that neither the trustee nor SIPC in its own right can bring any action under section 17(a) of the '34 Act. Neither can claim to be an intended beneficiary of that act since both are the

creatures of SIPA, enacted in 1970. Nor is either appellant a public investor. *Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 64-66 is dispositive of this issue.

Yet while denying to SIPC the right to bring a section 17(a) action on its own behalf, the majority also transmutes that entity into a subrogee clothed with the power in that capacity to bring a private damage action under 17(a) (an action itself now implied by the majority for the first time in the forty-four years section 17 has been on the books). By what alchemy a congressionally created corporation with limited powers to litigate, see *Securities Investor Protection Corp.* v. *Barbour, supra,* can now sue in a federal court for an alleged violation of section 17(a) of the '34 Act, is not made clear. When Congress created SIPC, its express but limited rights of subrogation were spelled out in SIPA: "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section." 15 U.S.C. § 78fff(f)(1). As the majority recognizes, those claims to which SIPC is subrogated by statute are clearly against the debtor's estate only and no rights against the accountant flow therefrom. Since Congress has delineated the subrogation rights of SIPC, its failure to provide for subrogation against any third party would clearly dictate that none exist under the previously discussed principle: *expressio unius est exclusio alterius. Rogers* v. *National Surety Co.*, 116 Neb. 170, 216 N.W. 182 (1927). The effect of the majority's extension of SIPC's subrogation rights is to circumvent the intent of Congress by ignoring the directive of SIPA that SIPC be subrogated *"with the rights and priorities provided in this section."* 15 U.S.C. § 78fff(f)(1) (emphasis supplied).

Similarly, the Trustee, held by the majority to have no direct cause of action under section 17(a), is

nonetheless found to have such capacity in his role as a bailee. The majority finds that his responsibility to marshal and return property to the customers of the debtor broker-dealer authorizes him to bring this action. But that responsibility of the Trustee is created by SIPA, 15 U.S.C. § 78fff(a)(1), and is inherent in his Trustee function, see also 15 U.S.C. § 78fff(b)(1). Having rejected his right to sue as a Trustee of Weis under *Lank* v. *New York Stock Exchange, supra,* I fail to see how denominating him a bailee adds a jot or a tittle to his statutorily created status as the representative of Weis—an entity regulated by, and precluded from suing under, the Act. Furthermore, the customers on whose behalf the Trustee seeks to maintain suit are not only entitled to bring, but have already initiated their own action against Touche Ross. See notes, 3, 9, *supra.* The SEC understandably has expressed no view on this point.

For these reasons I respectfully dissent and would affirm Judge Wyatt's decision below.

Judgment of the Court of Appeals

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the twenty-first day of April one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges,

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & Co.,
Defendant-Appellee.

77-7183

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

A. DANIEL FUSARO,
Clerk

By ARTHUR HELLER,
Deputy Clerk

Order Denying Petition For Rehearing

United States Court of Appeals

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

vs.

TOUCHE ROSS & Co.,
Defendant-Appellee.

Docket No. 77-7183

A petition for a rehearing having been filed herein by counsel for the appellee, Touche Ross & Co.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED

A. DANIEL FUSARO,
Clerk

Order Denying Rehearing En Banc

United States Court of Appeals

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, *Plaintiffs-Appellants,* v. TOUCHE ROSS & CO., *Defendant-Appellee.*	Docket No. 77-7183

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the appellee, Touche Ross & Co., and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED.

IRVING R. KAUFMAN
Irving R. Kaufman,
Chief Judge

Supreme Court, U. S.
FILED
SEP 22 1978
MICHAEL RODAK, JR., CLERK

In The

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

—against—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

BRIEF OF RESPONDENT EDWARD S. REDINGTON IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

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BRIEF OF RESPONDENT EDWARD S. REDINGTON IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

This brief is submitted by Edward S. Redington, Esq., (the "Trustee") in opposition to the petition of Touche Ross & Co. ("Touche Ross") for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered on April 21, 1978. The Trustee was appointed by order of the United States District Court for the Southern District of New York to liquidate the business of Weis Securities, Inc. ("Weis") pursuant to the Securities Investor Protection Act of 1970, 15

U.S.C. §§ 78aaa *et seq.* ("SIPA" or the "1970 Act").[1] The Trustee is also submitting contemporaneously herewith a cross-petition for certiorari requesting that this Court review or remand for consideration by the Second Circuit two additional issues which were raised but not decided below.

A separate brief in opposition to Touche Ross' petition is being submitted on behalf of the Trustee's co-respondent and co-plaintiff below, the Securities Investor Protection Corporation ("SIPC"). The reasons why a writ of certiorari should not be issued to review the decision of the Second Circuit that a private right of action should be implied under Section 17 of the Securities Exchange Act of 1934[2] are well stated in that brief and need not be repeated here. The Trustee's brief sets forth additional reasons why this narrow issue is neither ripe nor appropriate for review by this Court and why the Court should not review the Second Circuit's even narrower decision that the Trustee has standing to sue as bailee of property entrusted to Weis by the relatively few customers whose claims have not been satisfied in the course of the liquidation.

Additional Question Presented

In addition to the questions stated in SIPC's brief, the following question is raised by Touche Ross' petition:

> Whether the Trustee of a brokerage house in liquidation under SIPA has standing as a bailee to sue

1. After this action was commenced, the Securities Investor Protection Act was amended in certain respects in 1978. Pub. L. No. 95-283, 92 Stat. 249 (1978). Where reference is made to the Act as it existed before the amendments it will be called the "1970 Act".

2. 15 U.S.C. §§ 78a *et seq.* (hereinafter the "Exchange Act"). References to the Exchange Act are to that Act as it existed in 1973. The Act underwent immaterial amendments in 1975. Publ. L. No. 94-29, 89 Stat. 97 (1975).

> third parties in the interests of customers with unsatisfied claims who entrusted "customer property" to the debtor which is not considered part of the debtor's general assets and which the Trustee has special duties to marshal and return?

Counter-Statement Of The Case

From 1969 to the date of its forced liquidation in May 1973, Weis engaged Touche Ross as its accountant and auditor for various purposes, including especially the preparation, audit and certification of reports complying with the requirements of SEC Rule 17a-5, 17 C.F.R. § 240.17a-5 ("Rule 17a-5")[3] as well as with generally accepted accounting principles and generally accepted auditing standards. (Cplt ¶ 17.)[4] Among the series of audits and other accounting services which Touche Ross undertook to perform were those preceding Touche Ross' certification of Weis' Answers to Financial Questionnaire and other documents for Weis' fiscal year ended "as at May 26, 1972." Some of these documents were required to be filed with regulatory authorities by Section 17 and the rules and regulations thereunder. (Cplt ¶¶ 19-23.)

Because of the reliance placed on Rule 17a-5 audits by regulatory authorities, Rule 17a-5 has always required an accountant to make specific representations and certifications about the scope of its audit and the nature of its opinion with respect to a broker-dealer's statement of financial condition, especially as the accountant's examination related to a broker's compliance with rules adopted for the protection of customers. At the time of Weis' audit, for example, Subparagraph 17a-5(g)(2) expressly

3. The Rule as it existed at the time of the audit is set forth at pages 62a-70a of the appendix to Touche Ross' petition. Numerals followed by the letter "a" refer to the pages of that appendix.

4. Reference to "Cplt " are to paragraphs of the complaint. The complaint is contained in the appendix to SIPC's brief in opposition to Touche Ross' petition.

required the accountant to describe the scope of the audit made, whether the audit was made in accordance with generally accepted accounting principles and whether any procedures deemed necessary by the accountant were omitted. The subparagraph concluded by warning that no authority could be implied for omitting any procedures which would normally be employed for the purposes of the certifications required by the rule. (67a.) Subparagraph (h) required the accountant to "state clearly" the accountant's opinion "with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein." (68a.) Subparagraph (i) placed a duty on the accountant to flag potential trouble spots by requiring him to state "specifically and clearly" any "exception" he may have to "[a]ny matters" otherwise covered by his opinion. (68a.)

At the conclusion of the audit of Weis "as at May 26, 1972" Touche Ross signed opinion letters addressed to Weis' board of directors in which it falsely stated that it had performed all steps required by Rule 17a-5 and certified without reservation of any kind—and without any real basis in fact—the reliability both of Weis' financial and income statements and of its internal system of accounting control. (Cplt ¶¶ 24, 28.)

Despite the representations in the Touche Ross opinions, the report audited and certified by Touche Ross proved in fact to be materially false and misleading in many respects. Far from being subject to an adequate system of internal control, the Weis records had been manipulated by a small cadre of Weis officers and financial personnel[5] to disguise substantial operating losses and an unsatisfactory and rapidly deteriorating net capital ratio and financial position. For example, the income statements reflected an

5. The five Weis employees involved were indicted and sentenced for false financial reporting.

ostensible pre-tax profit of $1,700,000 when Weis had in fact lost at least $1,500,000; all of the reports misstated Weis' net worth and net capital position by substantial amounts. (Cplt ¶¶ 10, 29-31.)

Because Touche Ross gave Weis' financial reporting system a clean bill of health and failed to disclose the irregularities in its books and records, remedial action by Weis' board of directors and regulatory authorities that could have diminished or averted the losses suffered by customers and others in the Weis liquidation could not be taken. (Cplt ¶¶ 11-12, 31.) The deficiencies in Touche Ross' audit are thus alleged to have been the proximate cause of a SIPA liquidation in which the Trustee has been unable to make all of Weis' customers and creditors whole.

After a lengthy investigation by the Trustee under Section 167 of the Bankruptcy Act (11 U.S.C. § 567) (which included subpoenaing and reviewing the work papers prepared by Touche Ross in its 1972 audit) the Trustee and SIPC filed the complaint in this action in April 1976. Essentially, both plaintiff's allege that Touche Ross' 1972 audit of Weis was negligent, if not grossly negligent and reckless, and that Touche Ross breached specific duties to each plaintiff which it voluntarily assumed under Section 17 of the Exchange Act and under various principles of common law.

In his section of the complaint (Cplt ¶¶ 32-49) the Trustee claims that Touche Ross' false certifications and acts of misfeasance breached duties owed separately to Weis as the party which contracted for auditing and accounting services, as well as to customers who were the intended beneficiaries of the financial responsibility rules and the related auditing and certification requirements of Section 17 and Rule 17a-5. The Trustee's section of the complaint

also specifically alleges that Touche Ross' deficient auditing services caused damage to the customer property held by Weis as bailee in that they prevented Weis from preserving and safeguarding property which Weis held or should have held in trust for its customers. (Cplt ¶ 19a.)

After dismissal of the complaint by the District Court, the Court of Appeals sustained the Trustee's right to maintain an action under Section 17 as bailee of customer property on behalf of those customers of Weis whose claims could not be satisfied in full either from the customer property marshalled in the liquidation or through SIPC cash advances for missing property. The court also sustained SIPC's right to sue as subrogee of those customers whose claims were satisfied with unreimbursed cash advances. The court did not decide whether federal jurisdiction existed over the other, more substantial monetary claims asserted by the Trustee as successor to Weis for negligence, breach of contract and the like. Questions relating to the scope of this action, and to the nature of the remedy afforded SIPA trustees and SIPC under Section 17, were left for consideration by the District Court on remand.

I.

This Court Should Deny Touche Ross' Petition Because The Decision Of The Court Of Appeals That The Trustee Has Standing To Sue Is Not A Question Of National Importance, Is Not In Conflict With Decisions Of This Court And Is Supported By Well-Settled Principles Of Common Law.

In its decision the Second Circuit held that, as a bailee with special duties to marshal and return customer property which Weis had been required to keep separate from its own assets,[6] the Trustee had standing to maintain this action against Touche Ross for those customer claims which have not been satisfied in the liquidation either by the return of customer property or through SIPC cash advances. The Second Circuit's decision on this issue is entirely consistent with well-settled, centuries-old principles regarding the standing of bailees to sue for loss of bailed property and therefore provides no basis whatsoever upon which to issue a writ of certiorari in this case.

Touche Ross does not dispute that the Trustee is a bailee of Weis' customers under SIPA. Touche Ross simply requests that this Court review the Second Circuit's decision on a well-established point of bailment law which contradicts Touche Ross' position.

According to Touche Ross, the Trustee had no standing to sue on behalf of Weis' customers because a bailee may sue to vindicate only its own possessory interest as bailee and not the interests of its customer-bailors. (Certiorari Petition at 26.) Touche Ross' view of the law is incorrect. While it is true that a bailee's right to sue for injury to the

6. See the 1970 Act §§ 6(a)(1), 6(c)(2)(B), 6(c)(2)(C), 15 U.S.C. §§ 78fff(a)(1), 78fff(c)(2)(B), 78fff(c)(2)(C).

bailment entrusted to him is based on his special possessory interest in it the courts have long recognized the right of bailees to represent and requite the interests of bailors as well as their own possessory interests. In *The Beaconsfield,* 158 U.S. 303, 307 (1895), for example, this Court clearly indicated such a representative capacity of the bailee as follows:

> "The Beaconsfield having been sunk in a collision with the Britannia, her master and owner, as bailees of her cargo, proceeded against the Britannia for damages done to such cargo. This they had a right to do. *It is perfectly well settled that the carrier is so far the representative of the owner that he may sue in his own name, either at common law or in admiralty, for a trespass upon or injury to the property carried.*" (Emphasis added).

Accord, e.g., The W.C. Block, 71 F.2d 682, 683 (2d Cir.), *cert. denied,* 293 U.S. 579 (1934) ("For centuries it has been the settled rule, both at common law and in the admiralty, that either the bailor * * * or the bailee * * * might sue the tortfeasor for destruction of the bailed goods."); *Baldwin* v. *Hill,* 315 F.2d 738, 742 (6th Cir. 1963) ("With respect to third parties [a bailee] stands in the place of the owner [bailor]"); *Luckenbach Steamship Co.* v. *United States,* 315 F.2d 598, 605 (2d Cir. 1963); *Bradley* v. *St. Louis Terminal Warehouse Co.,* 189 F.2d 818, 823 (8th Cir. 1951). As the Court of Appeals noted (14a-15a) this principle is recognized in Rule 17(a) of the Federal Rules of Civil Procedure approved by this Court.

The premise of Touche Ross' argument—that two separate and severable interests emanate from a bailment and that the parties to the bailment can only bring actions to protect their own interests—also contradicts three elementary principles of bailment law: (1) either the bailor or

bailee can bring an action for the same injury to the bailed property, so that a recovery by one is a bar to a subsequent recovery by the other; (2) a bailee can sue for a full recovery beyond any direct harm to it and regardless of any liability it might have to the bailor; and (3) the bailee holds such recovery in trust for the bailor. As the New York Court of Appeals explained in *Rogers* v. *Atlantic, Gulf & Pacific Co.,* 213 N.Y. 246, 258, 107 N.E. 661, 664 (1915):

> "A bailee, though not liable to the bailor, may recover for the wrongful act of a third party resulting in the loss of, or injury to, the subject of the bailment. * * * If the bailee recovers, he holds the recovery as trustee for the bailor. A recovery by either bailor or bailee will bar an action by the other."

Contrary to Touche Ross' assertion, *Caplin* v. *Marine Midland Grace Trust Co.,* 406 U.S. 416 (1972), does not undercut the propriety of the Second Circuit's decision regarding the Trustee's standing. *Caplin* did not involve a SIPA Trustee with special duties to marshal and return to customers funds of "customer property" that are recognized as being separate from the debtor's own assets. In *Caplin,* no question of bailment law was presented. All *Caplin* held was that a Chapter X Trustee lacked standing to sue an indenture trustee for defaulting on its obligations to debenture holders.[7] No one ever contended that a cor-

7. Moreover, nowhere in *Caplin* did this Court indicate, as suggested by Touche Ross (Certiorari Petition at 27) that it would be possible to justify denying the Trustee standing as a bailee on the singular ground that Touche Ross could be subrogated to the rights of customers against the Weis Estate for damages paid to them as a result of Touche Ross' own misfeasance and negligence. The issue of subrogation was never reached by the Court even in the non-bailee context of *Caplin*. *See* 406 U.S. at 430. Touche

porate debtor (or its trustee) could be considered a bailee for its debenture holders.

Nothing in *Caplin* detracts from the long-settled rules which sanction actions by a bailee for injury to the subject of the bailment and which confer on the Trustee the right to sue in that capacity in this case. The Second Circuit properly decided that as bailee of customer property with special duties to marshal and collect that property, the Trustee may maintain this action on behalf of Weis' customer-bailors. There is no reason for this Court to disturb that decision.

Ross' argument that it would be entitled to such subrogation would be impossible to sustain. *German Bank* v. *United States*, 148 U.S. 573, 581 (1893). Indeed, although the majority of this Court in *Caplin* found it unnecessary to reach the subrogation issue in that case, the four dissenting Justices who did pass on the subrogation question (406 U.S. 339-40) pointed out that:

> "It is not imaginable that any court would ever hold that an indenture trustee, found culpably responsible for the default on debentures, would be subrogated with respect to funds which otherwise would go to innocent creditors or stockholders on the ground that paying money to them rather than to it would constitute unjust enrichment. A person 'who invokes the doctrine of subrogation must come into court with clean hands.' *German Bank* v. *United States*, 148 U.S. 573, 581." (406 U.S. at 440.)

Moreover, Touche Ross' attempt to extrapolate from the rationale of *Caplin* an argument that granting standing to the Trustee would be inconsistent with the rights of customers and lead to a multiplicity of litigation (Certiorari Petition at 27-28) also fails. As demonstrated above at pages 8-9, any recovery by the Trustee as bailee would be held in trust for customers and would be a bar to any further action by the customer against Touche Ross for the amount recovered by the Trustee.

II.

Touche Ross' Petition Should Be Denied Because Resolution Of The Issues Raised Will Not Have A Significant Impact On Litigation Under The Securities Laws In The Federal Courts.

In its petition Touche Ross also argues that certiorari should be granted because the implication of a private right of action under Section 17 will supposedly expose accountants making certifications under Rule 17a-5 to endless litigation by an indeterminate class of customers and that consequently the volume of litigation under the Exchange Act will be greatly expanded. (Certiorari Petition at 30-33.) This argument is echoed in the motion of the American Institute of Certified Public Accountants for leave to file an amicus brief in support of Touche Ross' petition. (Amicus Motion at 15.)

In its attempt to build a question of burning importance out of this issue Touche Ross has clearly overstated the case. The plain fact is that the prospective liability of accountants under Section 17 will arise only in exceptional situations which are similar to this case, and that even in those instances the accountant's liability would be limited to a small group of persons. As explained below, in the likely course of human events and under SIPA as recently amended, the class of potential plaintiffs would consist almost entirely of SIPC. Only in situations of exquisite rarity—where some customers cannot be made whole in a liquidation under the new SIPA—are suits by Trustees or individual customers even a theoretical possibility.[8]

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8. These situations, though rare, make it clearest that customers—those for whose benefit the accountant is required to certify that he has performed duties under Section 17—must have an effective remedy for non-performance of those duties. State law is based on rules of privity having nothing to do with federal regulation of the brokerage industry and cannot be looked to as a source of appropriate remedies. Section 27 of the Exchange Act (15 U.S.C. § 78aa), ignored in Touche Ross' petition, was designed by Congress for such situations.

The unusual conjunction of circumstances which gave rise to this litigation and under which an accountant's liability might arise in the future would require first, that a major brokerage house fail and be placed in liquidation; second, that the auditor breach its obligations under Section 17 to the customers of the brokerage house in a manner so egregious that effective remedial action becomes impossible (for example, as here, where Touche Ross is alleged to have failed to detect crude bookkeeping manipulations and acts of fraud and criminal conduct); and finally, that the collapse of the brokerage house be so complete that customer claims cannot be satisfied from property marshalled in the course of the liquidation.

This unhappy conjunction of circumstances is not an everyday event. It is the type of financial disaster which has occurred but rarely in our history, and for participation in which an accountant ought to anticipate liability. Weis, for example, is the only member of the New York Stock Exchange ever to be liquidated under SIPA.

Touche Ross' statistics on broker liquidations in the eight years since SIPA was enacted exaggerate what the future is likely to hold in store. Only a handful of the liquidations referred to by Touche Ross have occurred since 1973, and the amount of losses sustained by customers or even by SIPC in these post-1973 liquidations has not been substantial. *See* Securities Investor Protection Act Amendments of 1977, H.R. Rep. No. 95-746, 95th Cong. 1st Sess. 37, 38 (1977). As noted in the Senate Report of the SIPA amendments:

> "There have been 129 liquidation proceedings under SIPA since 1970, the great majority of those liquidations commenced in 1973 and earlier years. Because of better surveillance and other factors, the number of liquidations has been declining since that time."

Securities Investor Protection Act Amendments of 1978, S. Rep. No. 95-763, 95th Cong., 2d Sess. 5 (1978).

Because the circumstances that could give rise to a Section 17 action are so extraordinary, no cases involving Section 17(a) other than this one and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), have apparently arisen under that section in the forty-four years of its existence. One hundred twenty-eight SIPA liquidations other than this one have taken place; they have apparently produced no actions under Section 17. The actions that Touche Ross points to are all suits arising out of this liquidation. These circumstances underscore the fact that the Weis liquidation and Touche Ross' potential liability with respect to it are *sui generis.* They are understandably a matter of concern to Touche Ross, but that does not imbue them with broad national significance.

Touche Ross' assessment of the impact of the Court of Appeals' decision ignores the fact that SIPA has recently been amended to increase the levels of protection for customers and to provide greater flexibility in satisfying customer claims than existed under the Act in effect at the time of the Weis liquidation. *See* H.R. Rep. No. 95-746 *supra,* at 39-40; Securities Investor Protection Act, as amended, Pub. L. No. 95-283, 92 Stat. 249 (1978). The effect of these changes is to make it extremely unlikely that individual customers will suffer appreciable loss in a brokerage house collapse.[9]

If there were to be other liquidations comparable to Weis, they would produce no flood of lawsuits. Waves of cus-

9. Even under the original Act, the total number of customers whose claims were not satisfied in full (and whose claims could therefore conceivably have led to a suit either by a SIPC trustee or an individual claimant) in 123 liquidations, including Weis, between 1970 and the first six months of 1977, was 163, and their claims totaled only $3 million. H. R. Rep. No. 95-746, *supra,* at 23, 40. The Weis liquidation accounts for a substantial portion of both figures. Had the increased amounts of SIPC cash advances established by the SIPA amendments been in effect, the number of customers with unsatisfied claims would have been reduced to 21, and their claims would have totaled $1 million. *Id.* at 40.

tomer-plaintiffs and SIPA Trustees are not about to inundate the nation's federal courthouses. Few if any customers will suffer a loss in future liquidations. Such liquidations would therefore be likely to produce, at most, one plaintiff—SIPC, an entity created by Congress and ultimately accountable to it. And of course in the real world even SIPC will have cause to become a plaintiff only in the rarest of circumstances.

Grant of certiorari would surely be ill-advised here where Touche Ross asks the Court to act at a time when many aspects of Section 17 and the newly-amended SIPA await further development. Even in this very case, the Section 17 issue may have only an illusory importance. In addition to his claim under Section 17, for example, the Trustee has alleged five other substantial claims under state and common law based on the same facts as his Section 17 claim. As to those claims, the Trustee has asserted that the District Court has independent jurisdiction as a Court of Bankruptcy. These jurisdictional issues are presently before this Court on the Trustee's cross-petition for certiorari. Should this Court or the Second Circuit on remand uphold the Trustee's position on these issues the practical importance and need for deciding the Section 17 question would largely have disappeared.

Conclusion

For the foregoing reasons, the petition by Touche Ross for a writ of certiorari should in all respects be denied.

Dated: September 22, 1978

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

against

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

BRIEF OF RESPONDENT SECURITIES INVESTOR PROTECTION CORPORATION IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

Respondent (plaintiff-appellant below) Securities Investor Protection Corporation ("SIPC") submits this brief in opposition to the petition of (defendant-appellee below) Touche Ross & Co. ("Touche Ross") for a writ of certiorari, on the ground that no valid reasons are present for this Court's review of the decision of the Court of Appeals for the Second Circuit.

Opinions Below

In an opinion written by Judge Lumbard, the Court of Appeals held (1) that customers of a defunct brokerage firm have a right of action under Section 17(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78q(a), against an accounting firm which breaches its duty under that Section, and (2) that SIPC may assert that right of action as the subrogee of such customers.* Judge Timbers wrote an opinion in which he expressly concurred without qualification in Judge Lumbard's majority opinion. Judge Mulligan wrote a dissenting opinion disagreeing with the majority's holdings.

These opinions below, rendered on April 21, 1978, are not yet officially reported, and are printed in the Appendix to the petition for certiorari at 1a-35a.** On July 7, 1978, the Court of Appeals denied Touche Ross' petition for rehearing and suggestion for rehearing *en banc,* no active judge or judge who was a member of the original panel having requested that a vote be taken on said suggestion (38a-39a). The opinion of the District Court, which was reversed, is reported at 428 F.Supp. 483 (S.D.N.Y. 1977), and is printed in the Appendix to the petition for certiorari at 40a-58a.

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* The court below also held that respondent Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc. (the "Trustee"), may assert a Section 17(a) cause of action as the bailee of the property of the customers of the defunct brokerage firm. The Trustee is submitting a separate brief in opposition to the present petition for a writ of certiorari.

** References herein to the opinions below will be to those opinions as printed in the Appendix to the petition for certiorari. Numerals followed by the letter "a" refer to pages in that Appendix.

Counterstatement of Questions Presented

1. Having recognized that a broker's customers are the "favored wards" of Section 17(a) of the 1934 Act because Congress enacted that Section for their protection, and having further recognized that Section 17(a) imposes a duty on accountants because their failure to properly prepare the reports required by that Section deprives the broker's customers of the protection intended by Congress, did the Court of Appeals err in holding that a now-defunct broker's customers have a right of action under Section 17(a) against an accountant whose certified Section 17(a) reports were false and misleading?

2. Having recognized that Congress intended SIPC's statutory subrogation right to customer claims against a defunct broker's estate to be available in addition to, and not in derogation of, SIPC's common law subrogation rights against third parties, did the Court of Appeals err in holding that SIPC, may maintain an action as subrogee against the defunct broker's accountant?

Additional Statute Involved

Even though the basis for invoking the jurisdition of the federal courts here is Section 27 of the 1934 Act, 15 U.S.C. § 78aa, Touche Ross has omitted that Section from its list of "Statutes and Rules Involved" (petition for certiorari at 3). Section 27 broadly grants to "the district courts of the United States . . . exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. . . ." SIPC and the Trustee have invoked Section 27 because their action is brought to impose liability upon Touche Ross for its breach of the duty

created by Section 17(a) of the 1934 Act and the regulations thereunder. Significantly, unlike Section 18(a) of the 1934 Act upon which Touche Ross places such heavy reliance, and unlike the statutes involved in the cases cited by Touche Ross in support of its *expressio unius* argument, Section 27 does not limit access to the federal courts to a limited class of plaintiffs. Instead, it permits any protected person to enforce, through the federal courts, any liability or duty created by the 1934 Act and the regulations thereunder.

Counterstatement of the Case

The Purpose and Function of Section 17(a) and the Related Role and Duty of Accountants

Section 17(a) of the 1934 Act (59a) and the rules and regulations thereunder (62a-70a) require broker-dealers to file certain financial reports so as to assure their customers that the broker-dealer is financially sound enough to return the customers' cash and securities on demand. The vital function and purpose of these Section 17(a) reports in effectuating Congress' intention to protect brokers' customers was succinctly summarized by the court below:

> "In order to provide a complete and accurate picture of a broker's financial condition, the SEC requires that the broker enlist an independent accountant to audit and certify its statements, list any matters to which the accountant takes exception, and provide certain additional financial data. Rule 17a-5(b), (i), (k). Furthermore, a notice of any 'material inadequacies' found by the accountant in the broker's procedures must be sent to the broker's customers. Rule 17a-5(m)(3).
>
> "*The function of this arsenal of financial reports is to protect the broker's customers.* One of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325.
>
> "The net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its 'principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers.' Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967). As amended in order to take into account the creation of SIPC, the rule serves particularly to 'protect customers prior to the time when the broker's . . . assets would be [in]sufficient to satisfy customers in the event of liquidation.' Exchange Act Release No. 11,497, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,212.
>
> "It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. *Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows.*" (8a-9a, emphasis added.)

The Section 17(a) reports are filed with the appropriate regulatory authorities, which do not themselves verify the accuracy of the financial information contained therein, but rather rely on the broker-dealer's accountant to prepare and certify accurate financial information. Thus, cognizant of the essential role certified public acountants play in the scheme created by the 1934 Act and relying on this Court's recognition in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), that Section 10(b) of the 1934 Act and Rule 10b-5 thereunder impose a duty on accountants, the court below held at the outset that Section 17 of the 1934 Act also imposes a duty on accountants—upon whom the very efficacy of Section 17 depends (6a-7a).

Weis and Touche Ross

Weis Securities, Inc. ("Weis") was a broker-dealer subject to the requirements of Section 17(a) and the rules and regulations thereunder. Its 1972 Section 17(a) reports were prepared by and contained certifications made by Touche Ross, a firm of certified public accountants. However, these Section 17(a) reports and certifications therein were materially false and misleading.* Consequently, the regulatory agencies and Weis' customers were lulled into assuming that Weis was financially sound in 1972, when, in point of fact, it was virtually on the verge of bankruptcy, although still salvageable. Accordingly, these customers entrusted, or continued entrusting, their cash and securities to Weis.

By means of the 1972 Section 17(a) reports, Touche Ross effectively certified, and aided and abetted, the 3.2 million dollar fraud which Weis' subsequently indicted and convicted officers perpetrated on Weis' customers. In 1973, when Weis' true financial condition finally came to light and had further deteriorated so as to necessitate Weis' immediate forced liquidation, the cash and securities on hand were not sufficient to make Weis' customers whole. Thus, it became SIPC's obligation to satisfy, within certain statutory limits, the claims of Weis' customers. To date, this has resulted in the depletion of the SIPC fund by approximately fourteen million dollars.** Had Touche Ross properly fulfilled its Section 17(a) duties, the very purpose of that Section—the protection of Weis' customers *per se*—

* The complaint, which alleges Touche Ross' breach of its Section 17(a) duties in great detail, is annexed hereto as an Appendix (see pp. 29-58, *infra*). Because the allegations in the complaint must be accepted as true under the present posture of this case, they are incorporated by reference here.

** Customer and creditor claims for additional millions of dollars have also been asserted in the Weis liquidation and, to date, remain unsatisfied. See the Trustee's brief in opposition to the petition for a writ of certiorari.

would not have been defeated and the concomitant depletion of the SIPC fund would have been avoided.

SIPC and Its Claims

SIPC, a quasi-governmental, non-profit membership organization whose membership consists of virtually all the registered broker-dealers and national securities exchange members in this country, was created by and organized under the Securities Investor Protection Act of 1970 ("SIPA"), 15 U.S.C. §§ 78aaa, *et seq.** This Court succinctly summarized the background and purposes of SIPA in *SIPC* v. *Barbour*, 421 U.S. 412, 415 (1975):

> "Following a period of great expansion in the 1960's, the securities industry experienced a business contraction that led to the failure or instability of a significant number of brokerage firms. Customers of failed firms found their cash and securities on deposit either dissipated or tied up in lengthy bankruptcy proceedings. In addition to its disastrous effects on customer assets and investor confidence, this situation also threatened a 'domino effect' involving otherwise solvent brokers that had substantial open transactions with firms that failed. Congress enacted the SIPA to arrest this process, restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered brokers and dealers."

The last stated purpose, that of up-grading broker-dealer responsibility, was aimed at eliminating ". . . to the maximum extent possible, the risks which lead to customer loss." H.R.Rep. No. 91-1631, 91st Cong., 2d Sess. 28 (1970).

* SIPA was recently amended by the Securities Investor Protection Act Amendments of 1978, Pub. L. 95-283, 92 Stat. 249 *et seq.*

Consonant with its purposes, SIPA empowered SIPC *inter alia* to commence proceedings for the liquidation of those of its members whose precarious financial condition posed the threat of loss to its customers. In addition, SIPC was required to satisfy, within certain statutory limits, the claims of customers against a liquidated SIPC member's estate. Thus, SIPC was created as a protective device to avoid or minimize the losses which the customers of a broker-dealer may suffer by reason of the latter's financial difficulty. That device was triggered upon the belated discovery in 1973 of Weis' true financial condition: on May 30, 1973, the District Court for the Southern District of New York granted SIPC's application for a decree adjudicating Weis' customers as in need of the protection afforded to them by SIPA, ordered the liquidation of Weis, and appointed the Trustee to liquidate its business. Subsequently, SIPC provided some fourteen million dollars to the Trustee for payment of claims submitted by Weis' customers.

Had Weis' inadequate and rapidly deteriorating financial condition been discovered as early as 1972, Weis could still have been saved by prompt remedial action, such as the infusion of new capital or merger with another brokerage firm. Obviously, had Weis been saved, its customers' claims would not have arisen and the SIPC fund would not have been depleted as it has been. However, because Touche Ross' Section 17(a) certifications were false and misleading, the possibility of remedial action in 1972 was prevented, the forced liquidation of Weis in 1973 became inevitable, and SIPC's fourteen million dollar loss necessarily ensued.

Accordingly, after a lengthy and thorough investigation of the circumstances which brought about the Weis liquidation (and particularly Touche Ross' direct responsibility for that liquidation), SIPC and the Trustee commenced this action against Touche Ross on April 30, 1976, in the District Court for the Southern District of New York.* SIPC asserts eight claims in its complaint. Four of these claims are asserted in SIPC's own right (¶¶ 50-53, 59-63, 70-72, 78-80), and the other four are asserted by SIPC as subrogee of those Weis customers whose bankruptcy claims have been satisfied through the depletion of the SIPC fund (¶¶ 54-58, 64-69, 73-77, 81-85). Two of SIPC's direct claims and two of its subrogation claims arise under the 1934 Act (¶¶ 50-69), and the remaining four claims plead Touche Ross' common law liability.

The 1934 Act claims are the very essence of the complaint and are predicated upon Touche Ross' violation of the duty imposed upon it by Section 17(a), as to which federal jurisdiction is exclusive under Section 27 of the 1934 Act. The common law claims are asserted on the basis of pendent jurisdictions.**

The Holdings Below

The Court of Appeals held that Weis' customers have an implied Section 17(a) right of action against Touche Ross (7a-12a), and that because SIPC has satisfied their claims it may assert that right of action as their subrogee

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* SIPC and the Trustee have also commenced a state court action against Touche Ross which is virtually dormant. That action is, of course, far less comprehensive than the federal action since no Section 17(a) claims are asserted therein. Moreover, as the Court of Appeals noted, "The state court action was commenced first in a highly technical sense. It was begun by service of a summons without complaint (the complaint was not served until after filing of the federal complaint), and then apparently ignored for some months by mutual consent." (6a, n. 7). Significantly, the Court of Appeals, in remanding the action, expressly left it for the District Court to decide whether the federal action should be stayed pending determination of the state action (15a).

** Again significantly, the Court of Appeals expressly left it for the District Court to decide, on remand, whether to exercise pendent jurisdiction over SIPC's common law claims (15a).

(12a-13a).* In reaching this result, the Court of Appeals recognized that the express remedy provided in Section 18 of the 1934 Act for purchasers and sellers of securities is not determinative here because Congress enacted Section 17(a) for the protection of investors in their capacity as the *customers of a brokerage firm* to whom they entrust their cash and securities, not in their capacity as the *purchasers or sellers of securities* issued by some corporation (11a-12a).

The Reasons For Denying The Certiorari Petition

There simply is no valid reason for this Court to grant the petition for a writ of certiorari to the Court of Appeals for the Second Circuit. Certainly, as demonstrated hereinbelow, the considerations set forth in this Court's Rule 19 with respect to certiorari petitions are hardly present here.

I. Review Of The Decision Below By This Court Would Be Premature And Inappropriate

Not only are the narrow holdings below correct, fully consonant with the applicable decisions of this Court (see pp. 16-20, *infra*) and easily compatible with a Third Circuit decision in an unrelated case (see pp. 14-16, *infra*), but this action is neither ripe enough, nor are the issues involved herein recurrent or significant enough, to present an important question of federal law for review on a writ of certiorari.

First of all, this action is merely at the pleading stage, the court below having reviewed and reversed the granting of a motion to dismiss the complaint. Thus, no discovery has yet been undertaken with respect to such vital factual matters as: Touche Ross' involvement in preparing and certifying Weis' fraudulent Section 17(a) financial reports; the reliance of Weis' customers (whether explicitly or implicitly) on those reports; the reliance of the regulatory authorities (and SIPC) on those reports and the extent to which Weis' liquidation could have been avoided, and its customers' cash and securities could have been preserved, had Touche Ross performed its services for Weis in 1972 in a manner consonant with its duties under Section 17(a).

* With respect to footnote 13 in the majority decision below, which cursorily suggests that SIPC might not be able to maintain a Section 17(a) claim in its own right, see SIPC's accompanying conditional cross petition for certiorari.

Accordingly, the court below left it for the District Court to decide on remand "what the appropriate standard is for accountant liability under section 17" (15a). Touche Ross, on the other hand, seeks to have this Court make an abstract legal determination in an evidentiary vacuum in a case which, as Touche Ross admits, is the first of its kind under the 1934 Act. By so doing, Touche Ross ignores the fact that it would be far more appropriate for this Court to fashion a rule of law in the light of the facts which remain to be developed and crystallized in this case and perhaps in other cases under Section 17(a). This case is neither ripe enough, nor has Section 17(a) been sufficiently considered by courts below in the context of the situation here presented, to allow this Court to properly resolve the scope of accountants' duties and liabilities under that Section.

Moreover, the determination of the issues left by the Court of Appeals for the District Court may very well terminate this action in the federal courts and thereby, naturally, obviate any potential occasion for review by this Court. The Court of Appeals provided that:

> "Since we hold that both SIPC and the Trustee may maintain this action against Touche Ross, we remand to the district court for further proceedings consistent

with this opinion. We leave to it in the first instance a number of questions that will now arise: whether to stay the federal action pending determination of the state action; whether to exercise pendent jurisdiction over the plaintiffs' common-law claims; and what the appropriate standard is for accountant liability in actions under section 17, cf. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976)." (15a)

Of course, Touche Ross is undeterred by the fact that a review by this Court of the decision below would be premature. Instead, Touche Ross raises the specter of the opening of the "floodgates of litigation" as a result of the decision below.* However, for all its speculative and bloated assertions as to the potential recurrence of Section 17(a) cases and as to the singular significance of the decision below, Touche Ross cannot escape the fact that the context in which this action arises is extraordinary and, accordingly, the issues involved herein are of limited significance.

Touche Ross has been made a defendant in this action because of its actual facilitation of the collapse of a major brokerage firm. SIPC has invoked Section 17(a) because, had Touche Ross not violated its duties under that Section, the liquidation of Weis would have been avoided, the cash and securities entrusted to Weis by its customers would have been preserved, and the fourteen million dollars SIPC has lost would have been saved. This set of circumstances is rare indeed, and helps to explain why, as Touche Ross has noted, this is the first case of its kind in the 44 years since the enactment of Section 17(a). Brokerage firm liquidations are hardly a commonplace occurrence, and the

* The American Institute of Certified Public Accountants has sought leave to file an *amicus curiae* brief in support of its member's certiorari petition herein. As might be expected, in its proposed brief, the Institute also asserts the speculative and unfounded alarm of a plethora of litigation.

facilitation of such liquidations by accountants who defy their Section 17(a) obligations is, of course, even more extraordinary. Thus, the projection of the commencement of countless Section 17(a) actions against accountants is more imagined than real.

The invocation of the cause of action recognized by the court below would be triggered mainly when a broker is in such financial difficulty that its assets are insufficient to satisfy its debts to its customers. This factual setting is simply not one which presents the possibility of liability in an "indeterminate amount" to an "indeterminate class." Indeed, the very enactment of SIPA renders the possibility of a plethora of litigation under Section 17(a) particularly remote, since most claims filed by the customers of defunct brokers are fully satisfied through the depletion of the SIPC fund.

In any event, whether a customer of a defunct broker should have a Section 17(a) right of action against the brokers' accountant is hardly a question of great moment, except perhaps for the accountant himself and the customers. Similarly, the second holding of the court below, *viz.*, that SIPC is subrogated to the customer's claims against the accountant, may hardly be said to have widespread implications, although that holding is obviously significant as far as SIPC itself is concerned. Thus, the issues which would have to be considered should the petition for certiorari be granted are of importance to such a peculiar and narrow class of litigants that those issues are simply not worthy of this Court's attention.

Finally, the true significance of the decision below is its recognition, in accordance with Congress' own recognition, that the customers of a broker are, as such, entitled to protection, and that the accountant of a broker may not defy his Section 17(a) duties with impunity. Manifestly, the decision below is consistent with the national policy to protect investors in the securities markets, and thus the

public interest hardly requires a review of that decision by this Court.

II. The Second Circuit's Section 17(a) Holding Below Is Not In Conflict With The Third Circuit's Section 13(a) Holding

In attempting to persuade this Court that the Second Circuit's decision below is "in conflict with the decision of another court of appeals on the *same* matter" (Rule 19 of this Court, emphasis added), Touche Ross essentially relies on *dictum* in an Eastern District of Pennsylvania case which was affirmed by the Third Circuit in a decision which made no mention whatsoever of Section 17(a) of the 1934 Act. *In re Penn Central Securities Litigation,* 347 F. Supp. 1327, 1340 (E.D.Pa. 1972), relevant point adhered to on reargument, 357 F.Supp. 869, 876 (E.D.Pa. 1973), *aff'd,* 494 F.2d 528, 539-41 (3d Cir. 1974).

There, the District Court *held* only that Section 18(a) is the exclusive remedy for a violation of Section 13(a) of the 1934 Act (347 F. Supp. at 1340). Even though the plaintiffs (present and former shareholders of the Penn Central Company) had not alleged any violation of Section 17(a) (see 347 F.Supp. at 1332), the District Court lumped that statute together with other "provisions that require the filing of applications, documents and reports", and gratuitously suggested that "Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the Exchange Act" (347 F.Supp. at 1340). On reargument, the District Court adhered to its initial holding as to the quite obvious exclusivity of a Section 18(a) remedy for a Section 13(a) violation, and made no mention of Section 17(a). On appeal, the Third Circuit affirmed this holding, with no mention of Section 17(a). This may hardly be deemed to represent a conflict with the Second Circuit's holding here that the customers of a brokerage firm have a right of action under Section 17(a).

Moreover, the patent relevance of Section 18(a) to Section 13(a) only serves to highlight the inapplicability of Section 18(a) to the Section 17(a) claims asserted in the present case. Section 13(a) requires certain *issuers of securities* to file with the SEC such documents, information and reports as it prescribes "as necessary or appropriate for the proper protection of investors and *to insure fair dealing in the security*". If these filed statements are false or misleading, Section 18(a) provides a remedy to any person who, in reliance on them, "*purchased or sold a security at a price which was affected by such statement*". Thus, Sections 13(a) and 18(a) naturally go hand-in-hand: both were intended for the protection of purchasers and sellers of securities issued by corporations. However, Section 17(a) and Rule 17(a)-5 thereunder are concerned with the protection of an entirely different class of investors—*the customers of broker-dealers;* they simply do not share the concern of Sections 13(a) and 18(a) for the protection of investors *qua* purchares and sellers of securities.

The District Court in the *Penn Central Securities Litigation* case recognized that:

> "The legislative history with respect to Section 13(a) indicates that Congress enacted the provision to insure that investors would receive adequate periodic *reports concerning the operation and financial condition of corporations.*" (347 F. Supp. at 1340, emphasis added)

By way of contrast, the Second Circuit below recognized that:

> "The language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which *Weis' customers are members of a class peculiarly protected by Section 17.*
>
> • • •

> *"The function of this arsenal of [Section 17(a)] financial reports is to protect the broker's customers."* (7a-8a, emphasis added)

Manifestly then, Sections 13(a) and 18(a) are aimed at protecting investors insofar as they purchase the securities of a corporate issue; Section 17(a), on the other hand, is aimed at protecting investors insofar as they consider or continue entrusting their cash and securities to a stock broker. Thus, Section 17(a), unlike Section 13(a), cannot be wedded to Section 18(a), nor has the Third Circuit even implied, let alone held, that Section 18(a) provides the exclusive remedy for a Section 17(a) violation. Consequently, there is no conflict between the Third Circuit's affirmance in the *Penn Central Securities Litigation* case and the Second Circuit's decision here. The fact that Congress intended Sections 13(a) and 17(a) to serve separate and distinct purposes compels the conclusion that the Third Circuit's Section 13(a) holding and the Second Circuit's Section 17(a) holding are perfectly capable of coexisting without any intervention by this Court here.

III. The Decision Below Is Fully Consonant With The Applicable Decisions Of This Court

Far from conflicting with the applicable decisions of this Court, the decision below is fully consonant with this Court's consistent recognition, as most recently stated in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 21 (1977), that "where Congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied *in favor of the particular class intended to be protected by the statute*" (emphasis added). Indeed, in implying a Section 17(a) right of action in favor of the customers of defunct brokerage firm, the teaching of *Piper* was precisely adhered to by the court below:

> ". . . it is plain that brokers' customers are the favored wards of section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection." (11a)

Of course, in *Piper* the parties seeking the recognition of an implied right of action under Section 14(e) of the 1934 Act were themselves members of the very class Congress intended to *regulate* (430 U.S. at 37); here, on the other hand, as even Touche Ross and Judge Mulligan below concede, Weis' customers are none other than the members of the class Congress intended to *protect* under Section 17(a).*

Similarly, the decision below is perfectly consonant with this Court's *unanimous* decision in the seminal case of *J. I. Case* v. *Borak*, 377 U.S. 426 (1964), where a private right of action was implied under Section 14(a) of the 1934 Act. *Borak*, which this Court cited with favor in *Piper* (430 U.S. at 25),** supports the decision below in

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* While this Court stated in *Piper* that "[w]hether shareholders-offerees, the class protected by § 14(e), have an implied cause of action under § 14(e) is not before us, and we intimate no view on the matter" (430 U.S. at 42, n. 28), it seems apparent from this Court's repeated references to the fact that the plaintiffs were not members of the protected class, but rather, were members of the regulated class, that this Court would have been far more willing to recognize a right of action in behalf of shareholders-offerees, the class protected by Section 14(e). In fact, Justices Stevens and Brennan stated in their dissent that

> "No one seriously questions the premise that Congress implicitly created a private right of action when it enacted § 14(e) in 1968. Also beyond serious question is the proposition that the members of the class which Congress was especially interested in protecting may invoke the private remedy . . ."

and noted in the accompanying footnote that the question is not "*whether* the statute created an implied private remedy", but rather "*who* may invoke that remedy" (emphasis in original). 430 U.S. at 55.

** In his concurring opinion below, Judge Timbers emphasized the continued viability of *Borak* (17a), and pointed to Mr. Chief

(footnote continued on following page)

at least two vital respects. First, *Borak* recognized (377 U.S. at 432), as did *Piper* (430 U.S. at 25), that the intended beneficiaries of a statute may have a right of action implied thereunder in their favor where such an implication is necessary. Second, *Borak* recognized (377 U.S. at 432) as did the court below here (10a-11a, see especially note 12) that private enforcement is a necessary supplement to SEC action where the intended beneficiaries of a statute are the ones seeking to enforce it and the SEC does not have the capacity to itself effectuate the protection intended by Congress.*

It should also be remembered that the supplementation of SEC action by private enforcement was but one of the compelling reasons recognized by the court below as necessitating the implication of a Section 17(a) right of action. The court also observed that SEC injunctive actions and criminal prosecutions will hardly restore to customers the money they have lost upon the collapse of their brokerage firm (10a). And finally the court below quite correctly recognized that:

". . . it is evident that just as the problems caused by

(footnote continued from preceding page)

Justice Burger's opinion in *Piper*, 430 U.S. at 25, Mr. Justice Marshall's opinion in *SIPC* v. *Barbour*, 421 U.S. 412, 417 (1975), and Mr. Justice Rehnquist's opinion in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975), as evidence of this Court's reaffirmance of the *Borak* principle (17a, n. 1).

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* Of course, in *Piper* this Court did not find the SEC's "institutional limitations *alone*" (430 U.S. at 41, emphasis added) to be a sufficiently compelling reason for implying a right of action in favor of those who are not members of the protected class. However, here, as in *Borak*, the fact that the SEC cannot, nor is it supposed to, independently verify the § 17(a) financial information prepared and certified by the broker's accountants was relied upon below as further supporting the recognition of a right of action in favor of the members of the *very* class Congress sought to protect.

insolvent brokers are national in scope, so must be the standards governing their reporting. Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' customers varies widely. There is no reason to believe that the remedy sought herein is one traditionally relegated to state law". (11a)

In addition to being consonant with *Piper* and *Borak*, the decision below was entirely consistent with the longstanding principle, established in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33, 39 (1916), that a party subject to a statutory duty (as is Touche Ross under Section 17(a) and Rule 17a-5 thereunder) is also subject to liability for its violation of that duty. This principle of "statutory tort" has been repeatedly applied to recognize a right of action under various securities statutes. See, *e.g.*, *Baird* v. *Franklin*, 141 F.2d 238, 245 (2d Cir. 1944), *cert. denied*, 323 U.S. 737 (1944) (§ 6b of the 1934 Act); *Taussig* v. *Wellington Fund, Inc.*, 313 F.2d 472, 476 (3d Cir. 1963), *cert. denied*, 374 U.S. 806 (1963) (§ 34(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-34(d)); see also, *Franklin National Bank* v. *L. B. Meadows & Co.*, 318 F.Supp. 1339, 1341-42 (E.D.N.Y. 1970), for a convenient summary of the numerous securities statutes under which an implied right of action has been recognized. Thus, as the court below noted, "[a]t least since [*Borak*], it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons, those persons may sue for the 'statutory tort' committed when the duty is breached" (10a).

Moreover, the decision below is obviously faithful to this Court's recognition that the entire body of securities legislation is fundamentally remedial in nature. See, *e.g.*, *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *SEC* v. *Capital Gains Research*

Bureau, 375 U.S. 180, 186, 195 (1963). And, of course, since the court below carefully and correctly applied the analysis (7a-11a) required in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), it can hardly be contended that this Court's prescribed criteria for the implication of a right of action were unheeded.* Accordingly, the decision below in no respect conflicts with the applicable decisions of this Court.

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* Touche Ross contends, as did Judge Mulligan below (23a), that the *Cort* v. *Ash* analysis should never have been reached because, as they would have it, the *Cort* factors are inapplicable to a statute which provides some express remedy, albeit not a remedy of which the particular plaintiffs can avail themselves. However, as recently as last May, this Court itself negated this contention. In *Santa Clara Pueblo* v. *Martinez,* 413 U.S. 913 (1978), notwithstanding that the plaintiff did not invoke the express remedy provided in the Indian Civil Rights Act of 1970, this Court proceeded to make the *Cort* analysis to determine whether the additional remedy she did seek may be implied under that statute. Likewise, as Judge Timbers pointed out in his concurring opinion below (16a-17a), in *Blue Chips Stamps* v. *Manor Drug Stores, supra,* this Court applied the *Cort* language in reaffirming the implication of a right of action under Section 10(b) of the 1934 Act and Rule 10(b)-5 thereunder, even though an express remedy for purchasers and sellers of securities was expressly provided in Section 18 of the 1934 Act. Thus, contrary to Touche Ross', and Judge Mulligan's contention, the *Cort* analysis seems appropriate wherever a statute does not expressly provide the *particular* remedy sought by the plaintiffs, even though some different remedy is expressly provided. Here, the express remedy under Section 18(a) of the 1934 Act applies to an entirely different class (*i.e.,* purchasers and sellers of securities) than the one of which SIPC's subrogors are members (*i.e.,* customers of a brokerage firm). The customers must therefore look to Section 17(a) for enforcement of the protection Congress intended them to have by enacting that statute. Accordingly, the court below properly applied the *Cort* analysis in determining whether, and in concluding that, brokerage firm customers have a right of action under Section 17(a).

IV. The Decisions Of This Court Relied Upon By Touche Ross Are Not Applicable Here

Touche Ross attempts to create the appearance of a conflict by citing decisions of this Court which, in fact, are not applicable here. Thus, Touche Ross relies on *Blue Chip Stamps* v. *Manor Drug Stores, supra; National Railroad Passengers Corp.* v *National Association of Railroad Passengers,* 414 U.S. 453 (1974) ("Amtrak"), and *SIPC* v. *Barbour,* 421 U.S. 412 (1975), in support of its contention that Section 18(a) of the 1934 Act, which provides an express remedy for *purchasers or sellers of corporate securities,* is determinative of the question of whether a right of action may be implied under Section 17(a) in favor of its intended beneficiaries—*the customers of a brokerage firm.*

Citing *Blue Chip Stamps,* Touche Ross argues that, because of Section 18(a)'s purchaser-seller requirement, it was "anomalous" to judicially imply a right of action under Section 17(a) for persons who are not purchasers or sellers. However, the conclusion reached by this Court in *Blue Chip Stamps* that "[i]t would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for *comparable* express causes of action" (421 U.S. at 735-736, emphasis added) resulted from the following predicament confronting the Court: both Sections 10(b) and 18(a) of the 1934 Act were, on their face, addressed to the protection of purchasers or sellers of securities; yet, only Section 18(a) provided for an express right of action, the right of action under Section 10(b) having been judicially implied; and, notwithstanding that Section 18(a) contained a stringent purchaser-seller requirement, it was urged upon the Court that Section 10(b) should not. No such predicament is created by Section 17(a) because, unlike both Sections 10(b) and 18(a), it is not intended to protect purchasers or sellers of securities. It is intended

to protect the customers of broker-dealers. Consequently, it simply can *not* be said about Sections 17(a) and 18(a), as was said in *Blue Chip Stamps* about Sections 10(b) and 18(a), that those sections are "comparable", and no "anomaly" is created by keeping them apart.*

Equally unsuccesful is Touche Ross' attempt to find a conflict between the decision below and the decisions in *Amtrak* and in *Barbour*, both of which did hold that where a statute expressly provides that a particular person may enforce it, such a provision is exclusive. However, as the court below noted (9a), in *Amtrak* the right to enforce the statute was lodged exclusively with the Attorney General, and in *Barbour* only the SEC was statutorily empowered to enforce the statute involved. Here, on the other hand, the plaintiffs have predicated federal jurisdiction upon Section 27 of the 1934 Act, which broadly permits any protected person to enforce, through the federal courts, any liability or duty created by the 1934 Act and the regulations thereunder, obviously including Section 17(a) and Rule 17(a)-5 thereunder. Accordingly, not *Amtrak* or *Barbour*, but *Bell* v. *Hood*, 327 U.S. 678, 684 (1946), is the applicable decision here: ". . . where legal rights have been invaded, and a federal statute provides for a *general right to sue* for such invasion, federal courts may use any available remedy to make good the wrong done" (emphasis added). See also, *J. I. Case* v. *Borak, supra* at 433.**

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* Touche Ross makes a great deal of the fact, as did Judge Mulligan below, that both Sections 17(a) and 18(a) use the word "reports" and that "Section 18(a) follows upon the heels of section 17" (22a). However, such an "analysis" flies in the face of this Court's teaching that securities legislation, enacted for the purpose of avoiding fraud, is not to be construed "technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC* v. *Capital Gains Research Bureau, supra* at 195; see also, *Affiliated Ute Citizens* v. *United States, supra; Superintendent of Insurance* v. *Bankers Life & Casualty Co., supra.*

** Other applicable decisions of this Court further undermine Touche Ross' *expressio unius* argument. By invoking that doc-

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Quite understandably therefore, the court below was unpersuaded by Touche Ross' *Blue Chip Stamps, Amtrak,* and *Barbour* argument, and thus easily disposed of the attempt to wed Section 18(a) to Section 17(a) by stating:

> "Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.
>
> "Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced not to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se." (11a-12a)

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trine, Touche Ross, in effect, asserts that Section 18(a) impliedly abrogates Section 27 insofar as the enforcement of Section 17(a) is concerned, notwithstanding that "[i]t is a cardinal principle of construction that repeals by implication are not favored." *United States* v. *Borden Co.*, 308 U.S. 188, 198 (1939). Moreover, ". . . even the most basic general principles of statutory construction must yield to clear contrary evidence of legislative intent" (*Amtrak, supra* at 458); and, as is undisputed, Congress clearly intended Section 17(a) to protect brokers' customers *as such*, irrespective of whether they buy or sell securities issued by some corporation.

V. The Holding Below With Respect To SIPC's Subrogation Right Should Not Be Reviewed By This Court

Touche Ross also seeks to have this Court review the second holding of the court below, *viz.*, that SIPC may maintain a Section 17(a) cause of action as the subrogee of Weis' customers (12a-13a). Touche Ross again invokes the *expressio unius* doctrine and again cites *Amtrak, supra* at 458, in contending that the express subrogation right in Section 78fff (f)(1) of SIPA is SIPC's only subrogation right. That Section provides that SIPC shall be subrogated to customer claims against the debtor's estate. However, it should be noted that the issue of the extent of SIPC's subrogation right has been mooted, at least as to any future lawsuit, by the 1978 amendments to SIPA which expressly provide that SIPC's right of subrogation to customers' claims is "in addition to all other rights it may have at law or in equity," *e.g.*, subrogation right against third parties. § 9 of Pub. L. 95-283, 92 Stat. 266. Thus, this is hardly an issue with which this Court should concern itself.

Touche Ross' argument that, as a third party, it is immunized by Section 78fff(f)(1) from a SIPC subrogation claim is plainly contrary to Congress' intention and to this Court's applicable decisions. First, as the court below recognized:

> "Section 78fff is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section. However, there is no reason to believe that this was meant to destroy SIPC's general common-law right of equitable subrogation." (R. 13a)

Indeed Section 78bbb of SIPA provides that:

> "Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 apply as if this act constituted an amendment to, and was included as a section of, such Act."

And, in turn, Section 28(a) of the 1934 Act provides that:

> "[*t*]*he rights and remedies provided by this title shall be in addition to any and all rights and remedies that may exist at law or in equity.* . . ." (emphasis added)

Thus, SIPC's statutory subrogation right to customer claims against a debtor's estate is simply available *in addition to,* and not in derogation of, SIPC's common-law subrogation right to customer claims against third parties such as Touche Ross. Not surprisingly therefore, the Third Circuit, the only other Court of Appeals which has addressed the issue of SIPC's subrogation right, has reached the same conclusion as did the Second Circuit here. *SEC* v. *Albert Maguire Securities Co.*, 560 F.2d 569, 574 (3d Cir. 1977) (". . . upon payment to a customer, SIPC becomes subrogated to the customer's rights against third parties.").

Moreover, even if there were some valid basis for applying the *expressio unius* doctrine here (which there is not), this Court has cautioned that this doctrine must defer to "generally expressed legislative policy". *SEC* v. *Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943). In this regard, it should be noted that, as the court below recognized (13a), Congress' generally expressed policy was that SIPC recapture its expenses to the fullest extent possible.* Finally,

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* For example, SIPA Section 78fff(c)(2)(B)(i) provides:

> ". . . *there shall be repaid to SIPC, in priority to all other claims payable from such single and separate funds,* the amount of all advances made by SIPC to the trustee to permit the completion of open contractual commitments . . ." (emphasis added)

Likewise, SIPA Section 78fff(c)(2)(B)(ii) provides:

> ". . . all costs and expenses specified in clauses (1) and (2) of section 64a of the Bankruptcy Act shall be paid from

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as the court below also recognized (13a), Congress obviously did not intend, by its enactment of SIPA and its creation of SIPC, to benefit wrongdoers such as Touche Ross with a windfall. If, prior to the enactment of SIPA, Touche Ross would have been liable to brokers' customers for its violation of its Section 17(a) duties, it certainly should not be permitted to take advantage of the existence of the SIPC fund to escape liability.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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such single and separate fund in priority to the claims of such single and separate class of creditors, and *any moneys advanced by SIPC for such costs and expenses shall be recouped as such. . . .*" (emphasis added)

And of course, Section 78fff(f)(1), far from abrogating SIPC's common law subrogation right, is yet another example of Congress ' concern that SIPC recoup any losses it can.

APPENDIX

Complaint.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

76 Civ. 1981

(IBW)

PLAINTIFFS DEMAND A TRIAL BY JURY

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

against

TOUCHE ROSS & Co.,

Defendant.

Plaintiffs EDWARD S. REDINGTON, Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, by their respective attorneys, complaining of the Defendant, allege as follows:

JURISDICTION AND VENUE

1. This action arises under the Securities Exchange Act of 1934 (15 U.S.C. Sections 78a *et seq.*) (hereinafter the "1934 Act") and particularly under Section 17 thereof (15 U.S.C. Section 78q), the Securities Investor Protection Act of 1970 (15 U.S.C. Section 78aaa *et seq.*) (hereinafter the "1970 Act"), and the common law.

2. This Court has jurisdiction over Plaintiff Redington's claims by virtue of Section 27 of the 1934 Act (15 U.S.C. Section 78aa); Section 6 of the 1970 Act (15 U.S.C. Section 78fff); Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. Sections 11a(7), 502 and 515); Sections 1331 and 1334 of the United States Judicial Code (28 U.S.C. Sections 1331 and 1334); and principles of pendent jurisdiction. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

3. This Court has jurisdiction over the claims of Plaintiff Securities Investor Protection Corporation by virtue of Section 27 of the 1934 Act (15 U.S.C. Section 78aa), Sections 1331 and 1332 of the United States Judicial Code (28 U.S.C. Sections 1331 and 1332), and principles of pendent jurisdiction. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

4. Defendant has its principal place of business in this District and most of the acts alleged herein occurred in this District.

PARTIES

5. Plaintiff Edward S. Redington (hereinafter the "Trustee"), pursuant to the 1970 Act, was duly appointed by Order of this Court dated May 30, 1973 as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), has duly qualified, and is presently acting in such capacity. Section 6(b)(1) of the 1970 Act (15 U.S.C. Section 78fff(b)(1)) provides that a trustee appointed under the 1970 Act shall be vested, *inter alia,* with the same powers and title with respect to the debtor and the property of the debtor as a trustee in bankruptcy and a trustee under Chapter X of the Bankruptcy Act (11 U.S.C. Sections 501-676) have with respect to a bankrupt and a Chapter X debtor.

6. Plaintiff Securities Investor Protection Corporation (hereinafter "SIPC") is a non-profit membership corporation created by and organized under the 1970 Act whose members are, with certain statutory exceptions, all persons registered as broker-dealers under Section 15(b) of the 1934 Act (15 U.S.C. Section 78o(b)) and, with certain statutory exceptions, all persons who are members of a national securities exchange. SIPC has its principal place of business in the District of Columbia. At all relevant times Weis was a member of SIPC.

7. Defendant Touche Ross & Co. ("Touche Ross") is a partnership of certified public accountants with its principal place of business at 1633 Broadway in the City, County and State of New York. In or about 1969 Touche Ross was engaged by Weis as its independent certified public accounting firm, and Touche Ross continued to act in such capacity from about 1969 until about May 1973, when the forced liquidation of Weis commenced.

COMMON ALLEGATIONS

8. At all relevant times prior to May 30, 1973, Weis was a corporation registered as a broker-dealer with the Securities and Exchange Commission (the "SEC") and was engaged in the business of a broker-dealer in securities. From June 1965 until May 1973, Weis was a member of the New York Stock Exchange, Inc. (the "Exchange"), the self-regulatory organization designated by SIPC to examine Weis for compliance with the applicable financial responsibility rules which are imposed on broker-dealers pursuant to Section 6 of the 1934 Act (15 U.S.C. Section 78f) for the protection of the public as a minimum prerequisite for conducting a securities brokerage business.

9. For each of its four fiscal years 1968 through 1971 (ended May 31), Weis' audited financial statements reflected a profit. During early 1972 five of Weis' officers (the "Weis Five") became increasingly concerned that a fair and accurate presentation of Weis' results of operations for fiscal year 1972 would reflect that Weis was operating at a loss.

10. The Weis Five misstated the financial condition and results of operations of Weis in financial reports prepared at fiscal year-end 1972. These reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders. Such misstatements were accomplished, by *inter alia,* materially overstating assets, creating non-existent assets, understating liabilities, overstating income, and understating expenses. The purpose and effect of such material misstatements were, *inter alia,* to create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000 before taxes whereas in truth and in fact Weis had actually suffered losses in that period in excess of $1,500,000.

11. Had Weis' actual financial condition, its actual results of operations, and the misstatements in its books and records been truthfully reported at the end of Weis' 1972 fiscal year, Weis' 1973 forced liquidation under the 1970 Act would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved by a number of means including, *inter alia,* change in Weis' management, reversal of its policy of growth and expansion, curtailment or contraction of certain of its operations and business practices, gradual liquidation of some or all of its operations, or merger with another

securities firm. Moreover, if a liquidation of Weis had been necessary as the result of such truthful reporting, such liquidation could have occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later.

12. The incorrect and incomplete fiscal 1972 year-end reports prepared by or under the direction of the Weis Five were certified by Touche Ross as being correct and complete. Consequently, the doctoring of Weis' books, records and required reports, the deterioration of its financial condition and the violations of financial responsibility rules could not be nipped in the bud at a time when a forced liquidation of Weis could still have been avoided. Instead, during Weis' fiscal year 1973, Weis' financial condition deteriorated further as the Weis policy of expansion continued unabated. Weis incurred substantial operating losses, depletion of its assets, and depletion of the property held by Weis in trust for its customers. The Weis Five continued to make false and fictitious entries in Weis' books and records, and continued directly or indirectly to submit false reports to Weis, its Board of Directors, the SEC, SIPC, The Exchange, and Weis' customers, creditors, lenders and shareholders in order to conceal Weis' true financial condition.

13. Not until April and May of 1973, as a result of separate investigations by the Exchange and the SEC, did the misstatement of Weis' financial condition come to light. These investigations gradually revealed violations of financial responsibility rules, Weis' unsafe, unsatisfactory and deteriorating financial condition, and the lack of accuracy and reliability of any of its financial statements, including those certified by Touche Ross. These revelations and the resulting uncertainties with respect to Weis' true

financial condition prevented Weis from being saved as a going concern or being merged with another, financially more secure, brokerage firm, and resulted in Weis' forced liquidation under the 1970 Act.

14. On May 24, 1973, the SEC commenced an action in this Court (73 Civ. 2332) against Weis and the Weis Five for injunctive relief to prevent them from conducting the business of Weis in violation of the 1934 Act and the rules and regulations promulgated thereunder. Also on May 24, 1973 (the "Filing Date"), pursuant to Section 5(a)(2) of the 1970 Act (15 U.S.C. Section 78eee(a)(2)), SIPC applied in this Court for a decree adjudicating that the customers of Weis were in need of the protection of the 1970 Act. On May 30, 1973 (the "Date of Adjudication") such a decree was granted, the liquidation of Weis was ordered, and Plaintiff Edward S. Redington was appointed Trustee for the liquidation of the business of Weis.

15. Upon the entry of the decree referred to in the preceding paragraph, SIPC was required by the 1970 Act to provide, and did provide to the Trustee, funds for the payment of claims submitted by customers and certain other creditors of Weis and for certain administrative expenses of the liquidation.

16. At all relevant times, Defendant Touche Ross held itself out to Weis, the SEC, SIPC, the Exchange and the general public as possessing the ordinary skill, ability and expertise of certified public accountants in accounting and auditing matters, and as being qualified, *inter alia,* (i) to examine and audit the books, records and accounts of firms engaged in the securities business in accordance with generally accepted auditing standards, (ii) to express opinions with respect to the financial statements of such firms as fairly reflecting their financial condition and results of

operations in accordance with generally accepted accounting principles, and (iii) to prepare and assist in the preparation of the reports concerning such books, records, accounts and opinions required by Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder. Touche Ross further held itself out as being familiar with accounting and auditing practices and standards required by the SEC and the Exchange for firms engaged in the securities business.

17. From approximately 1969 until the Date of Adjudication, Touche Ross was engaged by Weis for valuable consideration to serve as Weis' independent certified public accounting firm. During this period Touche Ross agreed to conduct annual audits of the affairs of Weis and to issue opinions and prepare reports on its financial statements, all in accordance with Section 17 of the 1934 Act (15 U.S.C. Section 78q), generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the SEC and the Exchange. In accepting said engagement, Touche Ross agreed to perform said services in a thorough, proper, skillful and diligent manner.

18. Weis and its Board of Directors, customers, creditors, lenders and shareholders, and the SEC, the Exchange and SIPC relied on Touche Ross to apply the standards and expertise, to express the opinions, to make the certifications and to prepare or assist in the preparation of the reports discussed in paragraphs 16 and 17, *supra,* for the purposes, among others, of (i) protecting Weis from fraudulent activity of its officers, directors, agents, and employees; (ii) safeguarding the existence and use of Weis' assets; (iii) assuring the accuracy of financial data submitted directly or indirectly to the Exchange, the SEC and SIPC, and generally made available to the public; (iv)

determining whether Weis could continue to engage in business as a broker-dealer in securities; (v) determining whether or not significant restrictions and alterations in the scope and nature of its operations would be required in order for Weis to continue to engage in business as a broker-dealer; and (vi) making informed business decisions concerning the future operations of Weis on the basis of accurate financial information.

19. In or about late 1971 or early 1972, Touche Ross agreed with Weis to perform the aforementioned auditing and accounting services for the year 1972. Among other things, Touche Ross agreed (a) to prepare, cause to be prepared, and assist in the preparation of financial statements of Weis and to issue opinion letters with respect to said statements; (b) to audit the affairs of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations promulgated by the Exchange and the SEC pursuant to Sections 6 and 17 of the 1934 Act (15 U.S.C. Sections 78f and 78q); (c) to notify the Exchange promptly that such audit had been commenced; (d) to prepare an answer to the financial questionnaire (the "Answers to the Financial Questionnaire") of the Exchange based upon said audit; (e) to submit to the Exchange (i) a copy of the Answers to the Financial Questionnaire, (ii) an attestation that the requirements of the audit regulations had been observed in the conduct of the audit, and (iii) a statement that Touche Ross had made a review of Weis' accounting system, internal accounting control, and procedures for safeguarding securities; (f) to furnish to the Exchange comments relative to any material inadequacies found to exist in Weis' accounting system, internal accounting control, and procedures for safeguarding securities; and (g) to indicate any corrective action taken or proposed.

20. Weis' employment of Touche Ross as its independent certified public accounting firm was not merely a matter of private contract between Weis and Touche and Ross, but was required by the Exchange pursuant to its duty under Section 6 of the 1934 Act (15 U.S.C. Section 78f) to regulate its members' conduct of their businesses and supervise their financial condition for the benefit of the public. Touche Ross knew or should have known that Weis' engagement of an independent certified public accounting firm was a requirement of the Exchange and that it was for the benefit both of Weis in making decisions with respect to the operation of its business and of persons other than Weis.

21. Touche Ross' examination of and report on Weis' financial condition were not intended solely for the benefit of Weis but were, pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, intended for and submitted directly or indirectly to, *inter alia,* the SEC, the Exchange, SIPC, and Weis' customers, creditors, lenders and shareholders. The Exchange was the organization designated and relied upon by SIPC to examine Weis for compliance with the applicable financial responsibility rules and to alert SIPC of Weis' financial difficulty.

22. Touche Ross knew or should have known that its examination of and report on Weis' financial condition were a requirement of Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, and were for the benefit both of Weis and of persons other than Weis.

23. In accordance with its engagement agreement, Touche Ross purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972 and in connection therewith (a) certified, prepared, caused to be

prepared, and assisted in the preparation of financial statements of Weis; (b) certified and prepared Weis' Answers to the Financial Questionnaire; and (c) issued four opinion letters (the "1972 Opinion Letters") to the Board of Directors of Weis dated, respectively, July 7, 1972, July 7, 1972, July 21, 1972 and July 21, 1972.

24. By means of the foregoing, Touche Ross represented and certified that it had examined (i) the statement of Weis' financial condition as of May 26, 1972, (ii) Weis' Answers to the Financial Questionnaire as of May 26, 1972, (iii) Weis' consolidated balance sheet for the 52 weeks ended May 26, 1972, and (iv) Weis' consolidated statement of earnings for the five years ended May 26, 1972. The letter pertaining to the Answers to the Financial Questionnaire stated that the Touche Ross examination had been made "in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof . . . as [Touche Ross] considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission." The letter also stated that the Answers to the Financial Questionnaire presented fairly the financial position of Weis at May 26, 1972 in the form prescribed by the Exchange and the SEC in conformity with generally accepted accounting principles applied on a consistent basis. Each of the other three 1972 Opinion Letters stated that the Touche Ross examination had been conducted in accordance with generally accepted auditing standards and that the aforementioned financial statements presented fairly the financial position of Weis and subsidiaries at May 26, 1972, and the results of operations and changes in their financial position for the year and the five years then ended, in conformity with generally accepted

accounting principles applied on a consistent basis. (The 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements are annexed hereto as Exhibits A, B, C and D.)

25. Touche Ross knew, should have known and intended that Weis and its Board of Directors would rely on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements for various purposes, including those set forth in paragraph 18, *supra.*

26. Touche Ross knew, should have known and intended that the SEC, the Exchange and SIPC would rely on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in carrying out their respective regulatory, supervisory and protective duties with respect to Weis, in determining whether Weis was in compliance with the applicable financial responsibility rules, and in determining whether Weis was in financial difficulty.

27. Touche Ross knew, should have known and intended that Weis' customers, creditors, lenders and shareholders would rely directly or indirectly on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in making decisions whether to commence or continue their respective relationships with Weis.

28. Touche Ross breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner in that, among other things, it:

a. failed to audit, verify and examine the books, rec-

ords, accounts and financial statements of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC;

b. failed to prepare, cause to be prepared, and assist in the preparation of accurate financial statements of Weis and Weis' Answers to the Financial Questionnaire;

c. rendered the 1972 Opinion Letters, which were false, inaccurate and incomplete;

d. failed properly to test, study and evaluate Weis' system of internal accounting control;

e. failed to obtain competent evidential matter sufficient to afford a proper basis for the 1972 Opinion Letters;

f. falsely certified that it had examined Weis' books and records in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and SEC; and

g. failed to inform or otherwise alert Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC) (i) of the material errors in Weis' Answers to the Financial Questionnaire and in Weis' financial statements prepared in connection with the 1972 Touche Ross audit; (ii) of the existence of inaccurate and unreliable books and records with respect to Weis; or (iii) of the possibility that Weis was facing financial difficulty.

29. Specifically, among other things, Touche Ross failed properly to audit, verify and examine:

(a) the Scheinman Hochstin & Trotta liquidation omnibus account (the "SH&T Omnibus Account"), a claimed asset of $745,000. If Touche Ross had audited,

verified and examined the SH&T Omnibus Account in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that in or about April 1972 the SH&T Omnibus Account had been debited in the amount of approximately $625,000;

(2) that, contrary to generally accepted accounting principles, the offsetting credits for this debit were to one or more income accounts;

(3) that the purpose and effect of these improper credits were to overstate Weis' gross income by approximately $625,000 and its net income and net worth by approximately $312,500; and

(4) that an overstatement by this amount was a material overstatement because it constituted over 30% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and over 4% of Weis' claimed net worth as of that date.

(b) the Winslow, Cohu & Stetson ("WC&S") insurance claim receivable, a claimed asset of $1,285,000. If Touche Ross had audited, verified and examined the WC&S insurance claim receivable in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that, on or about May 8, 1972, the WC&S insurance claim receivable had improperly been increased in value (debited) from $600,000 to $785,000 because of interest purportedly payable on the claim;

(2) that, on or about May 25, 1972, the WC&S insurance claim receivable had improperly been

further increased in value (debited) to $1,285,000 because of a purported increase in the value of the claim;

(3) that, contrary to generally accepted accounting principles, the offsetting credits for these two debits had been made to various income accounts;

(4) that the purpose and effect of these improper transactions were to overstate Weis' gross income by approximately $685,000 and its net income and net worth by approximately $342,500;

(5) that an overstatement by this amount was a material overstatement because it constituted nearly 35% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and approximately 4.5% of Weis' claimed net worth as of that date.

(c) other false, fraudulent and improper entries, irregularities and accounting transactions in the books of Weis which included, *inter alia,* the following:

(1) The re-depositing into income accounts of at least $800,000 worth of checks which were purportedly drawn to pay vendors or other creditors, thus overstating Weis' net income and net worth by at least $400,000;

(2) The doubling (to approximately $432,000) of accrued commission income for May 22-26, 1972, thus overstating Weis' net income, net worth, and net capital by approximately $108,000;

(3) The improper crediting of income accounts with proceeds from a sale-leaseback transaction, thus overstating Weis' net income and net worth;

(4) The improper transfer of certain short security positions to dividend receivable accounts;

(5) The improper failure to record certain liabilities of Weis on the books of Weis;

(6) The manipulation of certain error acounts to reflect false credit balances of $100,000 to $200,000, which then were taken into income, thus overstating Weis' net income, net worth and net capital by approximately $50,000 to $100,000;

(7) The improper designation of up to $500,000 worth of miscellaneous receivables as "current" so that it was not necessary to deduct them from capital in computing Weis' net capital ratio under Exchange Rule 325, with the result that Weis' net capital ratio was made to appear to be below 10:1 and Weis thus was not precluded by Exchange Rule 326 from expanding its business.

30. Upon the discovery by Touche Ross of any one or more of the false entries or improper accounting transactions discussed in paragraph 29 above, Touche Ross would have had an obligation to report such discoveries, *inter alia,* to Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC); and it would have had an obligation to report such discoveries in the 1972 Opinion Letters and to refrain from issuing the 1972 Opinion Letters in the form they actually took.

31. As a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC:

a. the acts of the Weis Five as set forth in paragraphs 10 through 13 herein were not promptly discovered, and the Weis Five were able to continue to make false and fictitious entries in Weis' books, records and financial

statements in order to conceal Weis' true financial condition during its fiscal year 1973;

b. other misstatements and inaccuracies in Weis' books, records and financial statements were not discovered;

c. Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules;

d. Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from (i) knowing the true financial condition of Weis, (ii) performing their respective duties to safeguard the assets of Weis and the property Weis was holding in trust for its customers, (iii) taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis under the 1970 Act could have been prevented, and (iv) taking or causing to be taken appropriate and immediate action to avoid or reduce the costs of satisfying the claims of Weis' customers;

e. the acts of the Weis Five as set forth in paragraphs 10 through 13 herein were not discovered by Weis, its Board of Directors, the SEC, SIPC or the Exchange until April and May 1973 at which time the only remedial action that could be taken was the forced liquidation of Weis under the 1970 Act, which caused and continues to cause substantial injury to Weis and SIPC as well as Weis' customers, creditors, lenders and shareholders;

f. the assets of Weis and the property Weis was holding in trust for its customers were not on the Filing Date or thereafter sufficient to satisfy the claims of Weis' customers, creditors, lenders and shareholders;

g. Weis was unable to comply with the minimum financial responsibility rules which would allow it to conduct its business as a broker-dealer in securities, was unable to restore itself to a condition in which it could remain in business, and lost the value of its business and assets as a going concern;

h. the assets of Weis were wasted and mismanaged; and

i. Weis was caused to undertake financial obligations which it could not satisfy and which it would not or could not have undertaken had its true financial condition as of May 26, 1972 been known to Weis and its Board of Directors, the SEC, the Exchange and SIPC.

AS AND FOR PLAINTIFF TRUSTEE'S FIRST CAUSE OF ACTION

32. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

33. As a result of the errors and omissions of Touche Ross, including those set forth in paragraphs 28 through 30 herein, Touche Ross violated, and aided and abetted the Weis Five in violating, Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, which require broker-dealers such as Weis to file with regulatory authorities accurate and truthful reports of their financial condition, including reports such as those certified by Touche Ross, in order to ensure the integrity and safety of the nation's securities markets and of the brokers and dealers that participate therein.

34. Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the class of persons which Section 17 of the 1934 Act was designed to

protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934 Act. The injuries which have occurred to Weis, its creditors, customers, lenders and shareholders as a result of the liquidation of Weis were of the type that Section 17 of the 1934 Act was intended to prevent.

35. As a result of Touche Ross' violation of Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, its aiding and abetting of the Weis Five's violation of Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, and its breach of the duties imposed by Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, Weis, its creditors, customers, lenders and shareholders have suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

AS AND FOR PLAINTIFF TRUSTEE'S
SECOND CAUSE OF ACTION

36. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 34 herein as though here set forth in full.

37. As a result of Touche Ross' negligence per se in violating Section 17 of the 1934 Act (15 U.S.C. Section 78q), and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

AS AND FOR PLAINTIFF TRUSTEE'S
THIRD CAUSE OF ACTION

38. Plaintiff Trustee repeats and realleges each and

every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

39. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

AS AND FOR PLAINTIFF TRUSTEE'S
FOURTH CAUSE OF ACTION

40. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

41. The auditing and accounting services performed by Touche Ross with respect to Weis were performed in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete.

42. By reason of the foregoing reckless and grossly negligent conduct of Touche Ross, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

AS AND FOR PLAINTIFF TRUSTEE'S
FIFTH CAUSE OF ACTION

43. Plaintiff Trustee repeats and realleges each and

every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

44. In connection with the auditing and accounting services performed by Touche Ross and as compensation therefor, Weis paid Touche Ross a certain sum of money (the "Touche Ross Fee"), the amount of which is not presently known to Plaintiff Trustee.

45. By reason of Touche Ross' breach of and failure to perform its agreement to render said auditing and accounting services in a thorough, proper, skillful and diligent manner, Weis is entitled to general damages in the amount of the Touche Ross Fee and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

AS AND FOR PLAINTIFF TRUSTEE'S
SIXTH CAUSE OF ACTION

46. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

47. In its engagement letter with Weis and other communications to Weis, Touche Ross expressly and impliedly warranted to Weis that its services to Weis would be of a certain quality (i.e. that, *inter alia,* they would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC).

48. By reason of the breaches and failures of Touche Ross, including those set forth in paragraphs 28 through 30 herein, those services were not of the warranted quality and were wholly without value to Weis.

49. By reason of Touche Ross' breach of warranty of the quality of its services to Weis, Weis is entitled to general damages in the amount of the difference between the actual and warranted values of the services rendered, and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

AS AND FOR PLAINTIFF SIPC'S
FIRST CAUSE OF ACTION

50. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

51. Touche Ross' audit of Weis failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules and regulations promulgated thereunder, in that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements prepared by Touche Ross were false, inaccurate and incomplete.

52. As a consequence of the liquidation of Weis, the SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

53. As a result of Touche Ross' failure to comply with the auditing standards prescribed by the 1934 Act and the rules and regulations promulgated thereunder, and as a result of Touche Ross' breach of the duties it owed to SIPC thereunder, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
SECOND CAUSE OF ACTION

54. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

55. As a result of Touche Ross' failure to comply with the auditing standards prescribed by the 1934 Act and the rules and regulations promulgated thereunder, in that the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements prepared by Touche Ross were false, inaccurate and incomplete, Touche Ross breached the duties it owed to the customers and certain other creditors of Weis by misleading them into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

56. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 55, and to pay for certain administrative expenses of the liquidation.

57. But for Touche Ross' breach of the duties it owed to the customers and certain other creditors of Weis by its failure to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules and regulations promulgated thereunder, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have as-

serted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

58. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
THIRD CAUSE OF ACTION

59. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

60. Touche Ross had knowledge of or, but for its errors and omissions, should have had knowledge of the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements.

61. Touche Ross breached the duties it owed to SIPC by failing to inquire as to, and to disclose, the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements.

62. The SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

63. As a result of Touche Ross' aiding and abetting of the Weis Five's violation of the 1934 Act and the rules and regulations promulgated thereunder as discussed in paragraphs 60 and 61 hereinabove, and as a result of the consequent depletion of the SIPC fund as indicated in paragraph 62 hereinabove, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
FOURTH CAUSE OF ACTION

64. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

65. Touche Ross had knowledge of or, but for its errors and omissions, should have had knowledge of the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements.

66. Touch Ross breached the duties it owed to the customers and certain other creditors of Weis by failing to inquire as to, and to disclose, the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements.

67. The SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain

other creditors of Weis and to pay for certain administrative expenses of the liquidation.

68. But for Touche Ross' aiding and abetting of the Weis Five's violation of the 1934 Act and the rules and regulations promulgated thereunder, as discussed in paragraphs 65 and 66 hereinabove, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

69. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
FIFTH CAUSE OF ACTION

70. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

71. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

72. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein, and not as a result of any negligence of SIPC, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
SIXTH CAUSE OF ACTION

73. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

74. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein (and not as a result of any negligence of any customer or creditor of Weis), the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

75. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 74, and to pay for certain administrative expenses of the liquidation.

76. But for Touche Ross' negligence and malpractice, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

77. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
SEVENTH CAUSE OF ACTION

78. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

79. As a consequence of the liquidation of Weis, the SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

80. As a result of the malpractice of Touche Ross and its breach of the duties it owed to SIPC (and not as a result of any negligence of SIPC), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

AS AND FOR PLAINTIFF SIPC'S
EIGHTH CAUSE OF ACTION

81. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

82. As a result of the malpractice of Touche Ross and its breach of the duties it owed to the customers and certain other creditors of Weis (and not as a result of any

negligence of any customer or creditor of Weis), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and certain other creditors ultimately filed claims in the Weis liquidation proceeding.

83. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 82, and to pay for certain administrative expenses of the liquidation.

84. But for Touche Ross' malpractice, recklessness and gross negligence, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

85. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

WHEREFORE, plaintiffs demand judgment:

a. for $51,000,000 on Plaintiff Trustee's First Cause of Action;

b. for $51,000,000 on Plaintiff Trustee's Second Cause of Action;

c. for $51,000,000 on Plaintiff Trustee's Third Cause of Action;

d. for $51,000,000 on Plaintiff Trustee's Fourth Cause of Action;

e. for the amount of the Touche Ross Fee plus $51,000,000 on Plaintiff Trustee's Fifth Cause of Action;

f. for an amount which is the difference between the actual and warranted values of Touche Ross' services with respect to Weis, plus $51,000,000, on Plaintiff Trustee's Sixth Cause of Action;

g. for $14,000,000 on Plaintiff SIPC's First Cause of Action;

h. for $14,000,000 on Plaintiff SIPC's Second Cause of Action;

i. for $14,000,000 on Plaintiff SIPC's Third Cause of Action;

j. for $14,000,000 on Plaintiff SIPC's Fourth Cause of Action;

k. for $14,000,000 on Plaintiff SIPC's Fifth Cause of Action;

l. for $14,000,000 on Plaintiff SIPC's Sixth Cause of Action;

m. for $14,000,000 on Plaintiff SIPC's Seventh Cause of Action;

n. for $14,000,000 on Plaintiff SIPC's Eighth Cause of Action;

o. for interest on the amounts demanded herein;

p. for the costs and disbursements of this action; and

q. for such other, further and different relief as to the Court may seem just and proper.

Dated: New York, New York
April 30, 1976

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

–against–

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

REPLY BRIEF IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

–against–

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

REPLY BRIEF IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Petitioner Touche Ross submits this brief in reply to certain contentions first raised in the opposing briefs filed by the Trustee and SIPC.[1] As demonstrated in this reply brief, and contrary to the assertions of the Trustee and SIPC, (i) review of the decision of the Court of Appeals majority would not be "premature", (ii) the broad grant of jurisdiction in Section 27 of the 1934 Act does not abrogate the limitations expressly set forth in Section 18(a) thereof on private remedies for violations of the

[1] In accordance with this Court's Rule 24(4), this reply brief does not address or attempt to refute contentions the erroneous nature of which already is demonstrated in the Petition, or which are plainly insubstantial.

reporting provisions such as Section 17(a), (iii) the effort by the Trustee and SIPC to explain away the principle of the Third Circuit's conflicting holding in *In re Penn Central Securities Litigation* as restricted only to Section 13(a) cases misapprehends that the purpose of Section 18(a) is to delimit the scope of liability for misstatements in all reports required by the 1934 Act, and (iv) the class of plaintiffs who may seek to invoke the Section 17(a) remedy created by the Court of Appeals majority is not limited to SIPC and a small number of customers.

I

Review Of The Decision Of The Court Of Appeals Majority Would Not Be "Premature"

1. Review by this Court of the decision of the Court of Appeals majority would not require, as SIPC contends (SIPC Br. 11), this Court to "make an abstract legal determination in an evidentiary vacuum". This case is not like those in which this Court is asked to delineate the outer contours of an already well-recognized right of action, and in which a detailed evidentiary record would be useful and in many instances even necessary; moreover, it does not involve any question of proper application of recognized principles to the particular facts. Rather, it involves novel and important, but strictly legal, questions of statutory construction, *viz.*, whether Section 17(a) of the 1934 Act creates an implied private right of action in addition to the express remedy provided by Section 18(a) and, if so, who may maintain such implied right of action. No detailed evidentiary record is necessary or in any significant sense even useful to resolve those questions properly. The factual allegations of the complaint (reproduced in full in the appendix to SIPC's brief) are admitted for purposes of the Petition, and provide a more than ample factual basis

for this Court's decision.[2] As shown in the Petition (p. 34 n. 20), there is substantial precedent in this Court's decisions for reviewing a decision which, like that of the Court of Appeals majority here, raises at this procedural stage clear-cut threshhold issues of law which are important to the administration of the federal securities laws and which are fundamental to—if not determinative of—the further conduct of the action. Indeed, even in a case where the issue was the outer contours of an already well-recognized right of action under the federal securities laws, this Court only recently found that the allegations of the complaint provided a sufficient factual context, and granted certiorari at precisely the same procedural stage as here. *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977).

2. The purported possibility referred to by SIPC (SIPC Br. 11) that proceedings on remand may "terminate this action in the federal courts and thereby . . . obviate the need for review by this Court" not only does not make review by this Court at this stage inappropriate, but actually calls attention to the fact that such review is important—indeed, may present the only opportunity for this Court—to determine the extent to which plaintiffs may "federalize" what are essentially common law claims by the simple expedient of characterizing the conduct complained of as a violation of the federal securities laws. SIPC emphasizes, as one of the issues determination of which on remand may "terminate" this action, the question left by the Court of

[2] Since all the factual allegations are admitted for purposes of the Petition, there is no need, as SIPC contends, for "discovery" with respect to "such vital factual matters" (SIPC Br. 11). Moreover, there simply is no possibility that the Trustee or SIPC can "discover" any fact not alleged in the complaint which can have any bearing on the questions of law raised by the Petition.

Appeals majority for the District Court "whether to exercise pendent jurisdiction over the plaintiffs' common law claims" (SIPC Br. 11-12). The Trustee also stresses the significance of the common law claims, pointing to the existence of "other, more substantial monetary claims asserted by the Trustee as successor to Weis for negligence, breach of contract and the like", which arise "under state and common law based on the same facts as his Section 17 claim", and because of which "in this very case, the Section 17 issue may have only an illusory importance" (Trustee Br. 6, 14). Such emphasis by both SIPC and the Trustee on their common law claims indicates that they are using their ostensible claims under Section 17(a) merely as a pretext to get their common law claims into a federal courthouse, and that it is the common law claims which will be at the focus of the pre-trial proceedings and the trial. In such circumstances, despite the investment of federal judicial resources on the premise that the case involves a claim under the federal securities laws, the ultimate judgment very well may be grounded on state law. *Cf. Van Gemert* v. *Boeing Co.*, 520 F.2d 1373 (2d Cir.), *cert. denied*, 423 U.S. 947 (1975). If Touche Ross were to prevail, the use by the Trustee and SIPC of their Section 17(a) claims only as a pretext for litigating the common law claims in federal court would escape review here; significantly, even if the Trustee or SIPC were to prevail, the same probably would be true. *Cf. Rosado* v. *Wyman*, 397 U.S. 397, 403-405 (1970); *Kavit* v. *A. L. Stamm & Co.*, 491 F.2d 1176 (2d Cir. 1974). *See also Bell* v. *Hood*, 327 U.S. 678, 686 (1946) (Stone, Ch. J., dissenting). Thus, rather than being "premature", the Petition may present the only effective opportunity for this Court to review the important issues raised thereby.

II

The "Broad" Jurisdictional Grant In Section 27 Of The 1934 Act Does Not Abrogate The Limitations Set Forth In Section 18(a) On Private Remedies For Violations Of The Reporting Provisions

1. Pointing out that Section 27 of the 1934 Act "broadly grants" to the district courts jurisdiction of "all suits . . . and actions . . . brought to enforce any liability created by" the 1934 Act, SIPC argues that Section 27 "permits any protected person to enforce, through the federal courts, any liability or duty created by the 1934 Act and the regulations thereunder", and that, since it and the Trustee invoke Section 27 jurisdiction, the limitations in Section 18(a) on the express private remedy for reporting violations are to be disregarded here (SIPC Br. 3-4, 22). SIPC's argument is erroneous because even its most heavily relied upon cases do not hold, as SIPC would have it, that by virtue of Section 27 *all* provisions of the 1934 Act *per se* give rise to implied private rights of action to redress violations thereof. For example, even in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964) (SIPC Br. 17-19, 22), which did rely on Section 27, this Court stated that an implied right of action was available because it was "necessary" in order to achieve the purposes of Section 14(a). Similarly, this Court recently stated in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25 (1977) (SIPC Br. 16-18), that its decisions hold only "that *in some circumstances* a private cause of action can be implied with respect to the 1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies", *viz.*, only in circumstances "where congressional purposes are likely to be undermined absent private enforcement" (emphasis added). *Accord, Santa Fe Industries, Inc.* v. *Green*,

supra, 430 U.S. at 477 ("a private cause of action . . . should not be implied where it is 'unnecessary to ensure the fulfillment of Congress' purposes' "); *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 62-63 (1975); *cf. Bivens* v. *Six Unknown Named Agents,* 403 U.S. 388, 402, 406 (1971) (Harlan, J., concurring).[3]

2. Since Section 27 does not have the effect which SIPC would ascribe to it, the fact that Section 27 is broader then the jurisdictional provision involved in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) ("*Amtrak*"), does not, as SIPC argues (SIPC Br. 22), serve to distinguish *Amtrak* and its controlling impact here. This Court made clear in *Amtrak* that, although that case did involve a limited jurisdictional provision, the legislative history demonstrated a Congressional purpose thereby to authorize only a limited class of suits, *id.* at 457; therefore the analog here of the *Amtrak* provision is Section 18(a) (which likewise reflects a Congressional intent to permit only a limited class of actions for reporting violations) and not, as SIPC contends, Section 27.[4]

3. SIPC similarly errs in attempting to distinguish *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975) (SIPC Br. 22). Indeed, SIPC itself emphasizes (SIPC Br. 24) that SIPA, which was the statute involved in *Barbour,* expressly provides in Section 2, 15 U.S.C. § 78bbb, that it is to be construed as an amendment to, and as if it were included as a section of, the 1934 Act. Therefore, Section 27 presumably is as applicable to SIPA as it is to Section 17(a), and cannot serve to distinguish *Barbour,* where, despite such applicability of Section 27, this Court held that, in light of SIPA's limited express remedy, no private right of action could be implied to enforce SIPA's provisions.

[3]SIPC cannot avoid the true thrust of those cases by talking in generalities about "statutory tort" (SIPC Br. 19), or by citation to such cases as *Bell* v. *Hood, supra,* which is inapplicable here since it held only that jurisdiction existed to determine *whether* a federal cause of action existed.

[4]SIPC errs in stating that "in *Amtrak* the right to enforce the statute was lodged exclusively with the Attorney General" (SIPC Br. 22). The right to seek enforcement also was granted to a class of private plaintiffs, *viz.,* employees adversely affected by a labor agreement and their representatives. 414 U.S. at 456-457, 460.

4. SIPC also unpersuasively attempts to distinguish *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), which in the specific context of the 1934 Act applied the principle, recognized in *Amtrak* and *Barbour,* that it is improper to imply a remedy which would be broader than the express statutory remedy specifically provided for violation of a statute (SIPC Br. 21-22). SIPC misconstrues, and therefore misapplies here, this Court's statement in *Blue Chip Stamps* that it would be "anomalous" to expand the plaintiff class for a judicially implied cause of action beyond the bounds delineated by Congress "for *comparable* express causes of action" (emphasis added by SIPC). *Blue Chip Stamps* did not, as SIPC circularly argues, find Sections 10(b) and 18(a) to be "comparable" because both were intended to provide a means of protection to purchasers or sellers exclusively, for the very issue to be decided in *Blue Chip Stamps* was whether Section 10(b) did apply only to purchasers or sellers. Rather, Sections 10(b) and 18(a) were found to be "comparable" because they dealt with similar subject matter, and that finding was the premise for this Court's conclusion that the express purchaser-seller requirement of Section 18(a) must also

apply to implied rights of action under Section 10(b). To imply a right of action under Section 17(a) broader than the express remedy under Section 18(a) would be even *more* "anomalous" than to imply such a broader right under Section 10(b). The express Section 18(a) remedy deals not with circumstances which are simply "comparable" to those dealt with by Section 17(a); it deals with precisely the same circumstances, *viz.*, misstatements in reports required to be filed under Section 17(a). Consequently, the *Blue Chip Stamps* principle is not distinguishable and precludes the right of action under Section 17(a) implied by the Court of Appeals majority.[5]

5. SIPC argues incorrectly that the decision of the Court of Appeals majority is supported by the principle that federal securities legislation is "fundamentally remedial in nature" and "is not to be construed 'technically and restrictively, but flexibly to effectuate its remedial purposes' " (SIPC Br. 19, 22 fn.). In holding in

[5]In addition to relying upon Section 27 as a basis for simply ignoring the express remedy provisions of Section 18(a) and the principles of statutory construction which *Amtrak*, *Barbour* and *Blue Chip Stamps* require to be applied, SIPC seeks by reference to this Court's recent decision in *Santa Clara Pueblo* v. *Martinez*, 98 S. Ct. 1670 (1978), to support the use by the Court of Appeals majority, without reference to Section 18(a), of the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975) (SIPC Br. 20 fn.). SIPC's reliance on *Santa Clara Pueblo* is misplaced because (i) the statute there involved did not expressly provide *any* civil right of action, and only provided habeas corpus in situations involving confinement; and (ii) nonetheless, this Court, citing *Amtrak*, held that no implied remedy was available since "the structure of the statutory scheme and the legislative history . . . suggest that Congress' failure to provide remedies other than habeas corpus was a deliberate one". 98 S.Ct. at 1679.

Equally unpersuasive is SIPC's argument that recognition of Section 18(a) as an exclusive remedy provision would impermissibly "abrogate" Section 27 because it would amount to a "repeal by implication" thereof (SIPC Br. 22-23 2d fn.). As shown above, Section 27 simply grants jurisdiction; it does not create a right of action for all violations of the 1934 Act. Moreover, since Sections 18(a) and 27 were contemporaneously enacted, the concept of "repeal" is totally inapposite.

Blue Chip Stamps that the purchaser-seller requirement expressed in Section 18(a) is applicable to implied rights of action under Section 10(b) and Rule 10b-5, this Court rejected the view that such requirement is inconsistent with the principle upon which SIPC relies, concluding that "[h]owever *flexibly* we may construe the language of both provisions, nothing in such construction militates against the *Birnbaum* [purchaser-seller] rule" (emphasis added). 421 U.S. at 748-749. Moreover, in its recent decision in *Securities & Exchange Commission* v. *Sloan*, 98 S. Ct. 1702, 1710-1711 (1978), this Court emphasized that reference to the "remedial purposes" of the 1934 Act did not justify reading a particular provision "more broadly than its language and the statutory scheme reasonably permit", even assuming that as a result a "totally satisfactory remedy" would not be available "in every instance in which the [SEC] would like such a remedy".

III

In Erroneously Arguing That The Principle Of The Third Circuit's Decision In *In Re Penn Central Securities Litigation* Does Not Conflict With The Decision Of The Court Of Appeals Majority, SIPC Misapprehends The Purpose Of Section 18(a)

1. The Petition demonstrates (pp. 23-25) that the decision of the Court of Appeals majority implying a private right of action under Section 17(a) conflicts in principle with the decision of the Third Circuit in *In re Penn Central Securities Litigation*,[6] as well as with a substantial number of district court decisions, involving other reporting provisions of the 1934 Act. SIPC would erroneously distinguish the Third Circuit decision on the

[6]347 F.Supp. 1327 (E.D. Pa. 1972), *decision as to Section 13(a) adhered to on reargument*, 357 F.Supp. 869 (E.D. Pa. 1973), *aff'd*, 494 F.2d 528 (3d Cir. 1974).

ground that it "*held* only that Section 18(a) is the exclusive remedy for a violation of Section 13(a)" (SIPC Br. 14), a distinction which, as the District Court here recognized (50a; 428 F.Supp. at 489-490), is much too narrow and misses the pertinent point, *viz.*, that the Third Circuit's decision, and the district court decisions, all recognize, in holding that Section 13(a) and other reporting provisions do not create any implied private remedies, that Section 18(a) provides the exclusive remedy for *all* of the reporting provisions of the 1934 Act, including Section 17(a).

2. SIPC totally misconstrues the purpose of Section 18(a) when it asserts, in an effort to support its purported distinction of *In re Penn Central Securities Litigation*, that Section 18(a) is "inapplicab[le]" and "cannot be wedded" to Section 17(a) (SIPC Br. 15-16).[7] SIPC errs in those assertions because the language, context and history of Section 18(a)—and the fact that Section 18 is entitled "Liability for Misleading Statements" (instead of, for example, "Rights of Purchasers-Sellers")—plainly demonstrate that the Congressional intention underlying Section 18(a) was not simply to grant a remedy to purchasers and sellers, but to delineate the full scope of liability for misleading statements in filed reports by providing that purchasers and sellers were the only class of persons to whom a remedy for such statements was to be available. *Cf. Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 734 ("When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had

[7]That Section 18(a) surely is "applicable" to reports filed under Section 17(a) is demonstrated by the fact, which is noted in Judge Mulligan's dissent, "that in another suit arising out of the Weis debacle Judge Wyatt has sustained a section 18(a) claim asserted by a plaintiff bank which allegedly purchased securities of Weis in reliance on the section 17(a) reports involved in this case. *Exchange National Bank* v. *Touche Ross & Co.*, 75 Civ. 916 (S.D.N.Y.)" (26a [n. 5]).

little trouble in doing so expressly"). Indeed, the consistent and predominant pattern of the 1934 Act is to limit private remedies to purchasers and sellers. *Id.* at 735-736 ("The principal express nonderivative private civil remedies . . . are by their terms expressly limited to purchasers or sellers of securities").

3. Moreover, as the Petition demonstrates (pp. 19-20), SIPC's position is not advanced even by assuming for purposes of argument the correctness of its contention that Section 18(a) was intended only to protect purchasers and sellers and that Section 17(a) was intended to protect brokerage firm customers. SIPC's contention merely serves to emphasize that Congress' express provision in Section 18(a) of a remedy in favor of purchasers and sellers, and Congress' contemporaneous refusal to provide an express remedy to brokerage firm customers, necessarily reflect a Congressional intention that the customers *not* have any remedy, express or implied, under Section 17(a). *See also Amtrak, supra*, 414 U.S. at 457 (rejecting contention, based upon *Borak*, that a right of action under the Amtrak Act should be implied in favor of an association of railroad passengers because "railroad passengers are the intended beneficiaries of the Act").

IV

The Class Of Plaintiffs Who May Seek To Invoke The Implied Section 17(a) Remedy Created By The Court Of Appeals Majority Is Not Limited To SIPC And A Small Number Of Customers

The Trustee and SIPC seek to minimize the obviously substantial impact, in terms of increased federal caseloads, of the creation of an implied Section 17(a)

remedy (see Petition 29-33), by arguing that the class of plaintiffs who may seek to invoke an implied remedy under Section 17(a) is limited to SIPC and a small number of customers whose claims for the net equity in their accounts exceed the recently increased maximum amounts of protection provided under SIPA (Trustee Br. 11-14; SIPC Br. 13). However, that argument, among other reasons for being erroneous, improperly *assumes* that customers whose net equity claims do not exceed the SIPA limits, and whose claims therefore are "fully" satisfied to the extent of their net equity as computed pursuant to the formulae set forth in SIPA, do not have any damages the recovery of which they may seek under Section 17(a). Such an assumption is in fact inconsistent with the decision of the Second Circuit itself in another case arising out of the Weis debacle, *Rich* v. *New York Stock Exchange,* 522 F.2d 153 (2d Cir. 1975) (action under Section 6 of the 1934 Act), that brokerage firm customers who ostensibly have been compensated "fully" under SIPA nevertheless may be able to prove and recover *other* types of damages which arise from a brokerage firm liquidation but for which no compensation is provided under SIPA. Significantly, the Weis customers who already have sued Touche Ross as a result of the decision of the Court of Appeals majority here (see Petition 31) seek, *inter alia,* recovery of precisely the types of damages referred to in *Rich* v. *New York Stock Exchange.* Since *any* customer of a defunct brokerage firm can claim to have suffered such damages, the class of plaintiffs who may seek to invoke an implied Section 17(a) remedy is huge.

CONCLUSION

Touche Ross' Petition for a Writ of Certiorari should be granted.

October 25, 1978.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

Supreme Court, U.S.
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MICHAEL RODAK, JR., CLERK

TOUCHE ROSS & CO.,

Petitioner,

—*v.*—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,
Petitioner,

— *v.* —

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

OPINIONS BELOW

The majority, concurring and dissenting opinions of the United States Court of Appeals for the Second Circuit (A.190-A.224[1]) are not yet officially reported, and are unofficially reported at [Current Binder] FED. SEC. L. REP. (CCH) ¶96,404. The opinion of the United States District Court for the Southern District of New York (A.169-A.187) is reported at 428 F.Supp. 483.

[1] Numerals preceded by the letter "A." refer to pages of the separate Appendix filed herewith.

JURISDICTION

The judgment of the Court of Appeals (A.225-A.226) was entered on April 21, 1978. The Court of Appeals denied a timely petition for rehearing and suggestion for rehearing *en banc* on July 7, 1978 (A.227-A.228). The petition for a writ of certiorari was filed on August 23, 1978, and was granted on November 27, 1978. 47 U.S.L.W. 3368. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTES AND RULES INVOLVED

This case involves the following statutes and rule, as in effect in 1972: Sections 17(a) and 18(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§78q(a), 78r(a); Rule 17a-5 of the Securities and Exchange Commission, 17 C.F.R. §240.17a-5; and Sections 6(b)(1) and 6(f)(1) of the Securities Investor Protection Act of 1970, 15 U.S.C. §§78fff(b)(1), 78fff(f)(1). It also involves Rule 17(a) of the Federal Rules of Civil Procedure. Those statutes and rules are set forth in the appendix annexed to this brief.

QUESTIONS PRESENTED

1. Does Section 17(a) of the Securities Exchange Act of 1934, which requires the filing of certain reports by a securities brokerage firm, create in favor of customers of the brokerage firm an implied private right of action against accountants who audited such reports for damages resulting from misstatements therein, even though Section 18(a) thereof already expressly provides a limited private damage remedy for such misstatements, and even though the implied remedy under Section 17(a) would be broader than the limited express remedy of Section 18(a)?

2. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is a Trustee liquidating the business of the brokerage firm pursuant to the Securities Investor Protection Act of 1970 entitled to assert such implied right of action on behalf of customers whose property he is unable to return in the course of the liquidation?

3. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is Securities Investor Protection Corporation, upon advancing funds to the Trustee for the payment of claims of customers pursuant to the Securities Investor Protection Act of 1970, subrogated to such implied right of action of such customers, even though the Act expressly provides (in Section 6(f)(1)) only that Securities Investor Protection Corporation is subrogated, upon the advancement of such funds, to customer rights against the estate of the brokerage firm, and not to customer rights against third-parties such as accountants?

STATEMENT OF THE CASE

This is the second of two separate, but practically identical, actions commenced against petitioner Touche Ross & Co. ("Touche Ross") by respondent Edward S. Redington (the "Trustee"), as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), and respondent Securities Investor Protection Corporation ("SIPC"). This federal action—like the still-pending first action (the "State Court Action"), which was commenced in the New York State courts almost ten months earlier—arises out of the failure in May 1973 of Weis, a now defunct brokerage firm, and its still ongoing liquidation pursuant to the Securities Investor Protection Act of 1970 ("SIPA"), and seeks to impose liability of over $65,000,000 on Touche Ross, a firm of certified public accountants, because of alleged misstatements in Weis financial reports (the "1972 Weis financial reports")

covering periods ending May 26, 1972, which were audited by Touche Ross.

In this action, the Trustee and SIPC not only assert the same common law claims of accountants' negligence and malpractice, breach of contract and breach of warranty already asserted in the State Court Action, but also seek to "federalize" those claims, and thereby to gain access to the federal courts, by alleging that the conduct of Touche Ross which gave rise to the common law claims also violated Section 17(a) of the Securities Exchange Act of 1934 (the "1934 Act"). Section 17(a), which is one of the reporting provisions of the 1934 Act, requires the filing by broker-dealers of reports prescribed by the Securities and Exchange Commission (the "SEC"). The Trustee and SIPC—who concededly are unable to assert the sole *express* private damage remedy for misstatements in Section 17(a) reports, which is provided by Section 18(a) of the 1934 Act and which is limited to certain purchasers and sellers of securities—therefore contend that Section 17(a) itself provides an implied damage remedy which they may assert. That contention was rejected by the District Court, which dismissed the Section 17(a) claims for failure to state a claim upon which relief can be granted, and the common law claims for lack of subject matter jurisdiction; was in part accepted (for the first time since enactment of the 1934 Act) over a strong dissent by a divided Court of Appeals, which reversed the District Court; and raises the issues now before this Court for decision.

A. The Failure of Weis, The Appointment of The Trustee And The Indictment Of The Weis Officers.

In April or May 1973, the SEC and the New York Stock Exchange (the "Exchange") learned of a seriously deteriorating financial situation at Weis and of apparent

violations of the 1934 Act by Weis and its officers (A.9 [¶13], A.127 [¶8]). In May 1973, the SEC sought, and the United States District Court for the Southern District of New York granted, an injunction barring Weis and five of its officers (the "Weis Five") from conducting business in violation of the 1934 Act (A.10 [¶14], A.127 [¶9]). At the same time, SIPC applied for a decree adjudicating that the customers of Weis were in need of the protection of SIPA, and the District Court granted such a decree and appointed the Trustee to liquidate the business of Weis (*id.*). *See, e.g., Aldrich* v. *Redington (In re Weis Securities, Inc.)*, ___F.2d___, [1977-78 Transfer Binder] BANKR. L. REP. (CCH) ¶66,884 at 76,861-76,863 (2d Cir. 1978), *petition for cert. filed sub nom. Grossmann* v. *Redington,* 47 U.S.L.W. 3333 (Nov. 4, 1978) (No. 78-746); *Exchange National Bank* v. *Wyatt,* 517 F.2d 453, 455 (2d Cir. 1975); *Rich* v. *New York Stock Exchange,* 522 F.2d 153, 156 (2d Cir. 1975); *United States* v. *Solomon,* 509 F.2d 863, 864-865 (2d Cir. 1975); *Aldrich* v. *New York Stock Exchange, Inc.,* 446 F.Supp. 348, 352 (S.D.N.Y. 1977); *Rich* v. *Touche Ross & Co.,* 415 F.Supp. 95, 98 (S.D.N.Y. 1976).

In connection with the Weis collapse, the Weis Five were indicted in July 1973, in *United States* v. *Arthur Levine, et al.* (S.D.N.Y. 73 Crim. 693), for conspiracy, securities fraud, mail fraud, maintenance of false books and records, and filing of false Section 17(a) reports (A.117). Four of them, including Arthur Levine (former Chairman of the Board and Chief Executive Officer), Sol Leit (President and Chief Operating Officer), Joel Kubie (Comptroller and Executive Vice-President), and Robert Lynn (Assistant Comptroller and Vice-President), pleaded guilty to single counts of the indictment; the fifth, Alan Solomon (Treasurer and Executive Vice-President), was found guilty on one count after a non-jury trial, and his

conviction was affirmed (*see* A.117). *See United States* v. *Solomon, supra,* 509 F.2d at 865; *Aldrich* v. *New York Stock Exchange, Inc., supra,* 446 F.Supp. at 353, 355; *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.[2]

B. The Commencement Of The State Court Action In July 1975.

On July 3, 1975, the Trustee and SIPC commenced the still-pending State Court Action in the Supreme Court of the State of New York, County of New York, under the title (which is the same as the title of this action) *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76) (A.116, A.121-A.122, A.171, A.194).[3] The State Court Action involves the same parties as does this federal action, and the complaint there (A.123-A.145) makes the same factual allegations, asserts essentially the same claims and seeks the same aggregate damages of $65,000,000 as does the complaint here.[4] Although the State Court Action has been relatively inactive, Touche

[2] The SEC complaint, the indictment of the Weis Five and the criminal docket sheet showing the guilty pleas and verdict, although not reproduced in the separate Appendix, are in the Record as, respectively, Exhibits 4, 5 and 6 to the Roth moving affidavit (*see* A. 117).

[3] The State Court Action "has a 1976 number because the first paper filed in the action was in 1976" (A.171).

[4] The only material difference between the State Court Action and this action is the addition in the complaint here of the few allegations that the Trustee and SIPC deemed necessary to assert their Section 17(a) claims — *i.e.*, the few allegations by which they seek to "federalize" what are essentially nothing more than common law claims of accountants' negligence and malpractice. As the Court of Appeals majority put it, "[t]he common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under Section 17 of the [19]34 Act were omitted. Five of the Trustee's six present 'causes of action' appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims" (A.194).

Ross has commenced discovery therein (A.116, A.195 n.7).[5]

C. The Commencement Of This Action In April 1976.

On April 30, 1976, almost ten months after they had commenced the State Court Action, the Trustee and SIPC commenced this federal action (A.1, A.116, A.171, A.194).

D. The Complaint Herein.

1. GENERALLY.—The complaint herein (A.5-A.111), the factual allegations of which are deemed to be true for present purposes, contains six "causes of action" on behalf of the Trustee and eight on behalf of SIPC. Each of the "causes of action" is based upon the same set of "common allegations".

2. THE PARTIES.—The complaint alleges that the Trustee was "duly appointed" by order of the District Court dated May 30, 1973 (A.6 [¶5]). SIPC is alleged to be "a non-profit membership corporation created by and organized under" SIPA, and Weis is alleged to have been "a member of SIPC" (A.7 [¶6]). Touche Ross is alleged to be "a partnership of certified public accountants," which was engaged by Weis in 1969 as "its independent certified public accounting firm" and continued to act as

[5] The Trustee and SIPC have taken the position that the State Court Action was "commenced first only in a highly technical sense . . . [*i.e.*,] by service of a summons without a complaint (the complaint was not served until after the filing of the federal complaint)" (A.195 n.7), and is "practically dormant" (A.153-A.154). Even accepting those characterizations for present purposes (*but cf.* A.164-A.168), they miss the point. The significant thing about the State Court Action is not when the complaint therein was or was not served, and not whether it is or is not "dormant", but rather that it reflects that the facts on which the Trustee and SIPC base their claims have been understood by them since long prior to the commencement of this action to give rise to basically common law claims that may be pursued in the State courts.

such "until about May 1973, when the forced liquidation of Weis commenced" (A.7 [¶7]).

3. THE JURISDICTIONAL ALLEGATIONS.—The significant jurisdictional allegations for present purposes are that, with respect to its purported federal aspects, "the action arises . . . under Section 17" of the 1934 Act, and the District Court "has jurisdiction over . . . [the Section 17] claims by virtue of Section 27 of the 1934 Act" (A.5-A.6 [¶¶1-3]). Jurisdiction of the "common law" claims allegedly exists under "principles of pendent jurisdiction" (*id.*).[6]

4. THE "COMMON" ALLEGATIONS.—The complaint contains a group of so-called "common" allegations (A.7-A.21 [¶¶8-31]), which set forth the alleged factual basis for, and are expressly realleged in their entirety in, each of its "causes of action". The "common" allegations assert that Weis was a broker-dealer registered with the SEC and a member of the Exchange (A.7 [¶8]), and that events which had come to light in April and May 1973 by reason of "separate investigations by the Exchange and the SEC" resulted in Weis' liquidation pursuant to SIPA, which was ordered by the District Court on May 30, 1973 (A.9-A.10 [¶¶ 13, 14]).

The "common" allegations also assert that the Weis Five "misstated the financial condition and results of

[6] The complaint also alleges jurisdiction over the Trustee's common law claims by virtue of certain provisions of the Bankruptcy Act incorporated into SIPA (A.6 [¶2]). As noted hereinafter (pp. 14, 15 n.10, 17, *infra*), the District Court held that there was no such jurisdiction, the Court of Appeals expressly declined to pass on the issue, and this Court has not acted on the Trustee's cross-petition for certiorari in No. 78-493 seeking review of the District Court decision. The complaint also alleges jurisdiction of the common law claims under §§1331, 1332 and 1334 of the Judicial Code, 28 U.S.C. §§ 1331, 1332, 1334 (A.6 [¶¶2-3]), but the Trustee and SIPC abandoned such jurisdictional contentions after they too were rejected by the District Court.

operations of Weis" in the 1972 Weis financial reports in order to "create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000", whereas "Weis had actually suffered losses . . . in excess of $1,500,000" (A.8 [¶10]); that the 1972 Weis financial reports "were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act" and "were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders" (*id.*); that if "Weis' actual [1972] financial condition . . . [had] been truthfully reported", Weis' forced liquidation in 1973 "would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved" (A.8-A.9 [¶11]); and that even "if a liquidation of Weis had been necessary . . . such liquidation could have occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later" (*id.*).

Liability is sought to be imposed upon Touche Ross by reason of its allegedly improper audit and certification of the 1972 Weis financial reports (A.12 [¶19], A.13-A.14 [¶24]). It is alleged that Touche Ross "knew or should have known" that its engagement "was a requirement of the Exchange" and "was for the benefit both of Weis . . . and of persons other than Weis", and that "its examination of and report on Weis' financial condition were a requirement of Section 17 . . . and the rules and regulations promulgated thereunder" (A.12-A.13 [¶¶20, 22]); that Touche Ross "purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972" and in connection therewith "certified" and "issued . . . opinion letters" with respect to the 1972 Weis financial reports (A.13-A.14 [¶¶23, 24]); that Touche Ross "knew, should have known and intended" that Weis, its Board of Directors, the SEC, the Exchange, SIPC, customers, cred-

itors, lenders and shareholders "would rely" on its opinion letters and the 1972 Weis financial reports for various purposes (A.14-A.15 [¶¶25-27]); and that Touche Ross "breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner, and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner" (A.15-A.16 [¶28]).[7]

The "common" allegations then assert that various consequences followed "[a]s a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards . . . [and] accounting principles, and the audit regulations of the Exchange and the SEC" (A.19-A.21 [¶31]). It is alleged that, among such consequences, "the Weis Five were able to continue to make false and fictitious entries"

[7] Although the allegations that Touche Ross improperly audited and certified the 1972 Weis financial reports are assumed to be true for present purposes, it is noteworthy that in the "SEC . . . action in [the District] Court (73 Civ. 2332) against Weis and the Weis Five for injunctive relief" (A.10 [¶14]), the SEC complaint alleged violations of the securities acts in connection with the 1972 Weis financial reports *only against Weis itself and the Weis Five* (A.116-117). Even after the "separate investigations by the Exchange and the SEC" alleged by the Trustee and SIPC here (A.9 [¶13]), the SEC complaint did not allege that Touche Ross had committed or participated in or aided and abetted any such violations. Moreover, the indictment filed in the District Court against the Weis Five in *United States* v. *Arthur Levine, et al.* (S.D.N.Y. 73 Crim. 693) reveals that Touche Ross was as deceived as anyone else by the Weis Five. Thus the indictment expressly alleges in Count I (p. 5) that the Weis Five "*did fraudulently conceal from Weis' auditors, Touche Ross & Co.*, the existence and nature of the aforesaid fraudulent books and records and, in addition, . . . did create directly and indirectly wholly fictitious documentation for the aforesaid fraudulent entries" (emphasis added)—allegations which three of the Weis Five (Levine, Leit and Kubie) admitted by pleading guilty to Count I (A.117). *See* the SEC complaint, the indictment and the criminal docket sheet showing the guilty pleas (referred to at p. 6 n.2, *supra*). *See also Aldrich* v. *New York Stock Exchange, Inc., supra,* 446 F.Supp. at 352, 355; *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.

during 1973 (A.19 [¶31a]); "Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules" (A.19 [¶31c]); "Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from . . . taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis . . . could have been prevented" (A.20 [¶31d(iii)]); and "the assets of Weis were wasted and mismanaged" (A.20 [¶31h]).

5. THE TRUSTEE'S CLAIMS. — On the basis of the "common allegations", the Trustee asserts six "causes of action" (A.21-A.24 [¶¶32-49]), the first of which is his federal claim under Section 17, and the other five his common law claims. Each of his "causes of action" seeks alleged damages of at least $51,000,000, and is asserted both on behalf of Weis in its own right and on behalf of customers of Weis whose property the Trustee was unable to return because of the "depletion of the property held by Weis in trust for its customers" (A.9 [¶12], A.19-A.22 [¶¶31(d)-31(i), 34, 35]).

The Trustee's only federal claim is his first "cause of action" (A.21-A.22 [¶¶32-35]), which alleges that, by reason of the "errors and omissions" alleged in the "common" allegations, Touche Ross "violated, and aided and abetted the Weis Five in violating, Section 17 of the 1934 Act . . . and the rules and regulations promulgated thereunder" (A.21 [¶33]). The Trustee's second through sixth "causes of action" are common law claims of accountants' negligence and malpractice (A.22-A.23 [¶¶36-42]), breach of contract (A.23 [¶¶43-45]) and breach of warranty (A.24 [¶¶ 46-49]).

6. SIPC's CLAIMS. — On the basis of the "common" allegations, SIPC asserts eight "causes of action" (A.24-A.31 [¶¶50-85]), the first four of which are its federal claims under Section 17 and the other four its common law claims. Each of the "causes of action" seeks damages of at least $14,000,000 resulting from alleged depletion of the so-called "SIPC fund", from which SIPC allegedly provided to the Trustee "funds for the payment of claims submitted by customers and certain other creditors of Weis and for certain administrative expenses of the liquidation" (A.10 [¶15]). Four of SIPC's "causes of action" are asserted to recover in SIPC's own right damages that it allegedly suffered (A.25 [¶53], A.27 [¶63], A.28 [¶72], A.30 [¶80]), and four are asserted by SIPC as a purported subrogee "subrogated to those claims which . . . the customers . . . of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross" (A.26 [¶57], A.28 [¶68], A.29 [¶76], A.31 [¶84]).

SIPC's first and third "causes of action" (A.24-A.25 [¶¶50-53], A.26-A.27 [¶¶59-63]) are SIPC's claims in its own right under Section 17, the first alleging that Touche Ross violated Section 17 and the third that it aided and abetted the Weis Five's violation thereof. Its second and fourth "causes of action" (A.25-A.26 [¶¶54-58], A.27-A.28 [¶¶64-69]) are claims as a purported subrogee, the second alleging that Touche Ross violated Section 17 and the fourth that it aided and abetted.

SIPC's fifth through eighth "causes of action" are its common law claims of negligence and malpractice. The fifth and seventh "causes of action" (A.28 [¶¶70-72], A.29-A.30 [¶¶78-80]) assert such common law claims in SIPC's own right, and the sixth and eighth (A.29 [¶¶73-77], A.30-A.31 [¶¶81-85]) assert them for SIPC as a purported subrogee.

E. The Dismissal Of This Action By The District Court.

In the District Court, Touche Ross moved pursuant to Rule 12(b), F.R.Civ.P., to dismiss this action on the grounds, *inter alia*, that (i) the federal claims, being based solely on Section 17(a) of the 1934 Act, fail to state a claim upon which relief can be granted because Section 17(a) does not create any implied private right of action, and (ii) subject matter jurisdiction of the common law claims is lacking (A.112-A.113). The District Court, on the basis of a written opinion dated March 1, 1977 (A.169-A.187), and by order and judgment dated March 15, 1977 (A.188-A.189), granted the motion and dismissed the action.[8]

Noting in its opinion that "[i]n the 43 years during which the [1934 Act] has been on the books, there has been no decision whether a private right of action can be asserted for violation of Section 17" (A.177),[9] the District Court expressly held that no private right of action can be implied under Section 17(a). The District Court reasoned that, while there was no explicit statement of legislative intent with respect to such an implied right, the grant in Section 18(a) of an express and carefully limited remedy for misstatements in Section 17(a) reports (as well as for misstatements in reports filed pursuant to other reporting provisions of the 1934 Act) only to purchasers or sellers of securities in reliance upon such misstatements, "strongly

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[8] Touche Ross' motion also sought dismissal of certain of the common law claims for failure to state a claim upon which relief can be granted. Alternatively, the motion sought a stay of this action pending determination of the State Court Action. It was unnecessary for the District Court to reach, and it did not consider, those issues.

[9] As the District Court also noted (A.177), the question whether there is an implied private right of action under Section 17(a) of the 1934 Act expressly was left undecided in this Court's decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194 n.13 (1976).

suggest[s] a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18" (A.178). The District Court also concluded that it is not "necessary to imply a civil liability under Section 17 in order to enforce its provisions" (A.180).

The District Court explicitly followed recent decisions of this Court which recognize that it would be anomalous and improper to impute to Congress an intention to permit an implied remedy under the 1934 Act broader than the express statutory remedies specifically provided therein, and which emphasize that creation by judicial interpretation of an implied private damage remedy is proper only if it is necessary to effectuate Congress' goals (*see* A.178, A.182-A.183). *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 734, 736 (1975); *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 25-26 (1977). The District Court also followed a decision of the Court of Appeals for the Third Circuit, *In re Penn Central Securities Litigation,* 494 F.2d 528 (3d Cir. 1974), and various district court decisions, which hold that the reporting provisions of the 1934 Act do not themselves, in view of the express remedy provided by Section 18(a) and its careful limitation by Congress to certain purchasers or sellers of securities, create any implied private rights of action (*see* A.179).

Having held that the federal Section 17(a) claims of the Trustee and SIPC should be dismissed, the District Court then held that pendent jurisdiction over their common law claims was lacking (A.184-A.187), and that there was no other basis for exercising subject matter jurisdiction over the common law claims. The District Court expressly rejected, *inter alia,* the Trustee's contention that provisions of the Bankruptcy Act incorporated into SIPA provided such jurisdiction (A.184-A.186).

F. The Reversal Of The District Court By The Court Of Appeals.

On April 21, 1978, a divided Court of Appeals (Lumbard and Timbers, C.J.J., constituting the majority) (A.190-A.209), over a vigorous and well-reasoned dissent (Mulligan, C.J.) (A.209-A.224), reversed the District Court and remanded for further proceedings. The Court of Appeals majority held that customers of brokerage firms are a class "peculiarly protected by" Section 17(a), and therefore have an implied private right of action thereunder against accountants for misstatements in audited reports filed pursuant thereto (A.195-A.201), but expressly declined to set forth "the appropriate standard for accountant liability in [such] actions" (A.204).[10] Moreover, while recognizing that neither the Trustee on behalf of Weis nor SIPC in its own right has any right of action under Section 17(a) because they are not within any class protected thereby, the majority also held that the Trustee, as "bailee" of customer property that he has been unable to return, and SIPC, as "subrogee" of customers for the payment of whose claims it has advanced funds, may assert such right of action (A.201-A.204).[11]

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[10] The Court of Appeals majority also expressed no opinion as to the District Court's holding that, absent pendent jurisdiction, there is no other basis for subject matter jurisdiction over the common law claims (A.192 n.3). Moreover, even though it permitted the Trustee and SIPC to assert federal claims under Section 17(a), the majority also expressly declined to determine whether pendent jurisdiction over the common law claims should be exercised (A.204).

[11] The SEC submitted in the Court of Appeals a brief *amicus curiae,* which the majority thought "materially aided" its decision (A.192 n.3), and of which Judge Timbers thought Judge Mulligan in dissent had "disparagingly" spoken (A.206-A.208). Judge Mulligan's so-called "disparagement" consisted of his pointing out not only that the SEC's position was erroneous, but also that, as made clear by this Court in *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 41 n.27, the views of the SEC are of only "limited value" in this kind of case (A.209 n.1). *See also, e.g., International Brotherhood of Teamsters* v. *Daniel,* ___ U.S. ___, 47 U.S.L.W. 4135, 4138 and n.20 (Jan. 16, 1979) ("On a number of occasions in recent years this Court

Judge Mulligan, in his forceful dissent, would have affirmed the order of the District Court. He concluded that there is no implied private right of action under Section 17(a) (A.209-A.222), and that, even if there were such a right in favor of brokerage firm customers, the Trustee and SIPC are not proper parties to assert such right of action to recover customers' damages (A.222-A.224).

The judgment of the Court of Appeals (A.225-A.226) was entered on April 21, 1978.[12] The Court of Appeals denied Touche Ross' timely petition for rehearing and suggestion for rehearing *en banc* on July 7, 1978 (A.227-A.228).

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has found it necessary to reject the SEC's interpretation of various provisions of the Securities Acts"). As Judge Mulligan further noted, the position taken in the SEC brief—which had been submitted in support of SIPC's (but not the Trustee's) position—"was not only rejected below but was [in substantial part] repudiated by the majority in its footnote 13" (A.209 n.1).

[12] Within six days after the Court of Appeals decision, *customers* of Weis themselves commenced in the District Court a class action against Touche Ross asserting implied rights of action under, and seeking damages for alleged violations of, Section 17(a) as the result of the collapse of Weis. *Rosen* v. *Touche Ross & Co.*, (S.D.N.Y. 78 Civ. 1943). This Court may (and hereby is requested to) take judicial notice of such action. *E.g., Massachusetts* v. *Westcott*, 431 U.S. 322, 323 n.2 (1977). Another class action on behalf of *customers* of Weis had earlier been commenced against Touche Ross in the District Court and dismissed on the ground that the 1934 Act claims there asserted did not state a claim upon which relief could be granted under Sections 10(b) and 18(a) of the 1934 Act, but were at most non-federal, common law claims for negligence and malpractice which should be determined by the State courts. *Rich* v. *Touche Ross & Co.*, 415 F.Supp. 95 (S.D.N.Y. 1976). After such dismissal, the *Rich* plaintiffs, as have other customers, commenced a State court class action asserting the customers' claims against Touche Ross (A.118, A.220 n.9).

G. The Granting Of Certiorari By This Court.

On August 23, 1978, Touche Ross petitioned this Court for certiorari to review the holding by the Court of Appeals majority that the Trustee and SIPC could assert implied private rights of action under Section 17(a). On September 22, 1978, the Trustee cross-petitioned for certiorari in No. 78-493 to review the District Court's holding (which the Court of Appeals did not consider) that the Bankruptcy Act provisions incorporated into SIPA do not provide subject matter jurisdiction for his common law claims. On September 27, 1978, SIPC conditionally cross-petitioned for certiorari in No. 78-526 to review the holding by the Court of Appeals majority, with which Judge Mulligan in dissent agreed, that SIPC may not assert any Section 17(a) claim in its own right.

On November 27, 1978, this Court granted Touche Ross' petition. 47 U.S.L.W. 3368. It appears that the cross-petitions are still *sub judice.*

SUMMARY OF ARGUMENT

I

A. The federal claims of the Trustee and SIPC are based solely upon Section 17(a) of the 1934 Act, which is one of the reporting provisions thereof and which requires broker-dealers to file reports prescribed by the SEC. Section 18(a) of the 1934 Act sets forth the sole express private damage remedy for misstatements in reports required by Section 17(a) and the other reporting provisions, but the Section 18(a) remedy is limited to purchasers and sellers of securities who have been damaged by reliance on the misstatements.

B. Neither the Trustee, nor SIPC, nor any customer whose claims they purport to assert is within that

purchaser-seller class and they thus cannot assert the Section 18(a) remedy. Therefore, the Trustee and SIPC contend—and the Court of Appeals held (for the first time since enactment of the 1934 Act)—that Section 17(a) itself creates in favor of brokerage firm customers an implied private right of action for damages for misstatements in Section 17(a) reports, and that the Trustee (as the purported "bailee" of customer property that he has been unable to return in the Weis liquidation) and SIPC (as the purported "subrogee" of Weis customers for the payment of whose claims in the liquidation SIPC has advanced funds to the Trustee) may assert that implied right against Touche Ross, the accountants who audited and certified the 1972 Weis financial reports, which were required to be filed under Section 17(a) and contained misstatements.

C. However, Section 17(a) does not create any implied right of action for damages resulting from misstatements in reports required thereby, and the Court of Appeals erred in holding to the contrary. The statutory scheme—with its express and carefully limited damage remedy in Section 18(a) for misstatements in Section 17(a) reports—reflects a Congressional intention that a damage remedy for such misstatements would be available only to the purchasers and sellers specified in Section 18(a), and requires the conclusion that it would be improper to imply an additional, broader damage remedy under Section 17(a) itself in favor of brokerage firm customers who are not purchasers or sellers.

Thus, this action does not present an appropriate situation for application of the factors set forth in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), upon which the majority improperly relied and which expressly limited application of those factors to determining "whether a private remedy is implicit in a statute not expressly providing one"—a

limitation again emphasized in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 27 (1977). The statutory scheme here—rather than being one where (as in *Cort* v. *Ash*) no express remedy whatsoever is provided for violation of the statute under which a remedy is sought to be implied—is one in which Congress already expressly has provided both its desired statutory requirement (Section 17(a)) and the remedy (Section 18(a)) it thought necessary and appropriate for violations of that requirement. Consequently, the controlling decisions are *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) *("Amtrak"),* and *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), which establish that, in light of the doctrine *expressio unius est exclusio alterius,* and in the absence of clear contrary evidence of legislative intent, a remedy is not to be implied from a statutory provision for which a limited express remedy already is provided; and *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), which recognizes that it is improper to imply broader remedies under the 1934 Act than the express statutory remedies specifically provided therein.

Since there is, as even the Court of Appeals majority conceded, no evidence of any Congressional intent to create an implied private right of action under Section 17(a), *Amtrak, Barbour,* and *Blue Chip Stamps* require a holding that Section 17(a) does not create any implied right of action. Moreover, as *Blue Chip Stamps* also makes clear, it is inappropriate to eliminate the purchaser-seller requirement of Section 18(a)—which is a part of the predominant pattern of the 1934 Act and the Securities Act of 1933 (the "1933 Act") to provide private remedies to those damaged in the purchase or sale of securities—by implying a Section 17(a) right of action not subject to that requirement. The purchaser-seller requirement of Section 18(a) is designed to avoid "vexatious litigation" by, *inter*

alia, ensuring that claims for damages caused by misstatements in reports required by the 1934 Act (including Section 17(a) reports) will be based upon concrete, "objectively demonstrable" actions (*i.e.,* the purchase or sale of securities) taken in readily demonstrable reliance on such reports, rather than—as here—upon speculative and unreliable claims as to what actions *might have* been taken by the SEC and other regulatory authorities with respect to the Weis situation, and what *could have* or *might have* or *might not have* occurred at Weis, had the allegedly true facts been known. Moreover, *Blue Chip Stamps* and other decisions of this Court reject any view that the purchaser-seller requirement is inconsistent with the principle that the 1934 Act is to be "flexibly" construed to achieve its "remedial" purposes.

Numerous recent decisions, including two decisions of the Third Circuit, recognize that the principles of *Amtrak, Barbour* and *Blue Chip Stamps* require the conclusion that Section 18(a) is the exclusive remedy for misstatements in reports required by the 1934 Act and that no other remedies should be implied from the reporting provisions themselves in favor of plaintiffs who are unable to satisfy the purchaser-seller requirement.

The Court of Appeals majority erred in that it misapprehended the statutory scheme of the 1934 Act and the importance of the express Section 18(a) damage remedy for misstatements in Section 17(a) reports; it improperly relied upon a *Cort* v. *Ash* analysis despite its express limitation to determining "whether a remedy is implicit in a statute *not expressly providing one*", 422 U.S. at 78, and its consequent inapplicability here in light of the existence of Section 18(a); it failed to apply the analysis required by the controlling decisions in *Amtrak, Barbour* and *Blue Chip Stamps;* it failed to take into account the various protections already provided by Congress for

brokerage firm customers by the regulatory scheme—protections which include preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970) both as part of the monitoring system and as a source of funds to pay customer losses, criminal and injunctive proceedings to deter violations of the regulatory scheme, and the availability of State law remedies; and it failed to recognize that Congress in limiting the express private damage remedy in Section 18(a) to purchasers-sellers necessarily intended that such a remedy *not* be added to the protections already provided for the customers.

D. Moreover, even where a private damage remedy is sought to be implied from a provision of the 1934 Act for which there is no express remedy whatsoever, *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25-26, holds that a private right of action is not to be implied unless it is "necessary" to effectuate the Congressional goals, *i.e.,* where the Congressional purposes are likely to be "undermined" absent private enforcement. The Court of Appeals majority failed properly to take into account the "necessity" factor of *Piper,* which requires a holding that there is no implied right of action under Section 17(a) because implication of such a right of action is not, and was not considered by Congress to be, "necessary" to effectuate the goals of Section 17(a), and because the Congressional purpose will not be "undermined" absent such an implied right.

The primary purpose of Section 17(a) is to provide for reports which are part of an extensive system of preventive monitoring intended to help prevent brokerage firm insolvencies, and not to create private lawsuits for damages after such insolvencies have occurred. The SEC has available to it investigative, criminal and injunctive proceedings to enforce compliance with the regulatory

scheme, including Section 17(a). Since 1970, when SIPA was enacted, the regulatory scheme has included SIPC, with not only the function of participating in the preventive monitoring of the brokerage firms and seeking liquidation of such a firm where necessary, but also with the function of ensuring that brokerage firm customers are protected against loss by providing funds to pay the losses of such customers. And, of course, there are available to such customers the usual State law remedies, including common law actions for damages against accountants.

Under such a regulatory scheme, it is not necessary to imply a private right of action under Section 17(a), and in the 45 years since enactment of the 1934 Act the regulatory scheme has operated without a single court other than the Court of Appeals majority here finding it appropriate—let alone necessary—to imply such a right of action. The criminal and injunctive sanctions, the threat of liquidation under SIPA, and the State law remedies are all available and are sufficient deterrents to Section 17(a) violations.

As *Piper* points out, the further deterrent effect of implying a private damage action is so speculative that it does not provide "significant additional protection." *Piper* also makes clear that the necessity test is not met simply because an implied Section 17(a) remedy would be consistent with the regulatory scheme, or because the SEC has practical limitations on its ability to monitor every brokerage firm. Furthermore, there is no need to obtain, by implying a Section 17(a) remedy, nationally uniform standards for actions brought to recover losses after a brokerage firm has failed; this is clear from *Piper* and from *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 478 (1977), which restated the principle that where State law remedies traditionally have been available, federal courts should be reluctant to intrude federal remedies into the

area to serve " 'at best a subsidiary purpose' of the federal legislation".

It is also important that the primary purpose of Section 17(a) differs from that of the prospectus, antifraud and proxy provisions, which are intended to provide data directly to investors to aid them in their investment (*i.e.,* purchase and sale) and corporate voting activities, with respect to which the SEC has only an oversight role, and with respect to which implication of private remedies therefore may be necessary to the extent that express remedies are not provided. Section 17(a) reports, on the other hand, are not intended primarily for use by investors, but rather for use by the SEC and other regulatory authorities in performing their functions. Investors thus are not normally directly affected by Section 17(a) reports in making investment decisions but are affected only consequentially by the overall success or failure of the SEC and regulatory authorities, and in that context there is no necessity to create judicially an implied damage remedy under Section 17(a).

E. As noted, the Court of Appeals majority erred in relying (despite the existence of the express Section 18(a) remedy for misstatements in Section 17(a) reports) upon the factors enumerated in *Cort* v. *Ash* for determining "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added), 422 U.S. at 78, and in failing properly to take into account the "necessity" factor which *Piper* requires as a part of any *Cort* v. *Ash* analysis. However, even if the factors specifically identified in *Cort* v. *Ash* were assumed to be the only appropriate ones for consideration, they too require the conclusion that Section 17(a) creates no implied private right of action and that the Court of Appeals majority erred in holding to the contrary.

First, the existence of Section 18(a) shows that insofar as private rights of action for damages may be derived from reporting obligations imposed by the 1934 Act, only purchasers and sellers, and not customers, are *the class for whose special benefit such rights and remedies are provided.* Second, the statutory scheme reflects a *legislative intent* to deny a Section 17(a) remedy, since Section 18(a) provides an express private right of action only for damages to purchasers and sellers of securities who rely in their securities transactions upon misleading reports filed under Section 17(a). Third, an implied right would *not be consistent with the legislative scheme* since it would effectively abolish the purchaser-seller limitation that Congress placed on express damage remedies. Fourth, the causes of action that the Trustee and SIPC allege normally are asserted in common law actions for accountants' negligence and malpractice, and the purchaser-seller requirement of Section 18(a) shows a Congressional understanding that any cause of action by customers for damages is *one traditionally relegated to State law* which, under "well established tort law principles" provides appropriate remedies—remedies which are being pursued as against Touche Ross by the Trustee and SIPC in the State Court Action, and by Weis' customers themselves, and to which they all appropriately should be relegated.

F. The Court of Appeals majority also erroneously relied upon *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), and its "statutory tort" theory, both of which have been significantly restricted by more recent decisions of this Court. *Borak* is distinguishable from this action, in that, *inter alia,* (i) there was no express remedy provided in the 1934 Act for violations of the proxy provisions of Section 14(a), the statutory provision there involved, whereas here Section 18(a) does provide an express remedy for

misstatements in Section 17(a) reports, (ii) Section 14(a) did not simply impose a reporting requirement, as does Section 17(a), and (iii) Section 14(a) dealt with proxy statements designed specifically to influence investor decisions (*i.e.,* corporate voting decisions), whereas Section 17(a) reports are primarily for the information of the SEC and other regulatory authorities, and are not intended primarily to aid or influence investors in their investment or voting decisions.

G. Serious policy considerations militate against implication of a private right of action under Section 17(a). First, such implication would significantly broaden the class of potential plaintiffs seeking to impose liability on accountants who perform services and render expert opinions with respect to matters under the 1934 Act beyond the purchaser-seller class Congress delineated in Section 18(a), thereby raising difficult issues that are legislative in nature but that have not yet been addressed by Congress. Section 17(a) and its legislative history do not provide any standards that would enable the courts properly to articulate the scope of any implied civil liability thereunder, and there is the danger that accountants would be held responsible for all damages that the regulatory authorities might have been able to prevent, and would virtually be made insurers of the regulatory scheme's success.

Second, such implication would have the serious potential for unnecessarily adding to the already large volume of litigation under the 1934 Act in the federal courts, and thereby further burdening them with, a substantial amount of additional litigation which essentially involves accountants' negligence and malpractice, and which traditionally has been, and more appropriately should be, adjudicated in the State courts. If such a right of action is implied, all customers of failed or failing

brokerage firms (and possibly even customers of brokerage firms which are not failing, of which there are over 5,000) will have a potential Section 17(a) right of action against third parties allegedly responsible for misstatements in Section 17(a) reports.

Third, and as already noted, such implication would eliminate the purchaser-seller requirement of Section 18(a) and, as recognized in ***Blue Chip Stamps,*** inordinately increase the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs". 421 U.S. at 740, 743-749.

Fourth, since Section 17(a) is a reporting provision, a holding that a private right of action may be implied thereunder would be authority for implying rights of action under all of the other reporting provisions of the 1934 Act in favor of persons who are not purchasers or sellers and who therefore may not assert the express remedy provided in Section 18(a). Numerous plaintiffs already have unsuccessfully sought to assert such implied rights, and affirmance of the holding of the Court of Appeals majority here only would give new impetus to such efforts.

II

A. Even if Section 17(a) were held to create an implied private right of action in favor of brokerage firm customers against their brokerage firm for misstatements in its Section 17(a) reports, it does not in any event create such an implied right against accountants. Section 17(a) neither mentions nor imposes any duty upon them. While SEC Rule 17a-5 does refer to accountants, it does not by its terms impose any duty on them, and any interpretation thereof that would impose such a duty would impermissibly expand the scope of the rule beyond the power granted to the SEC by Section 17(a).

B. Section 17(a) does not in any event create such a right in the absence of *scienter* (which the Trustee and SIPC do not allege), because any implied right of action based on negligence would be *broader* than the express remedy of Section 18(a), and would be inconsistent with this Court's recognition of *scienter* as a necessary element of implied remedies. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

III

A. Even if Section 17(a) did create implied private rights of action in brokerage firm customers against accountants, the Trustee is not entitled as a "bailee" to assert any such rights on behalf of the Weis customers whose property he has been unable to return. The Trustee succeeded only to the rights of Weis itself, and not to any rights of the Weis customers that Weis itself could not assert. The Trustee thus may assert rights as a "bailee" only to the extent that Weis could have asserted such rights. The common law doctrine of bailment that permits a bailee to sue a third party for loss of, or injury to, the bailed property is based on *the bailee's own possessory rights,* and not upon any theory that the bailee is the representative, or is asserting the rights, of the bailor. It treats the bailee, insofar as a third-party wrongdoer is concerned, as owner of the property for all purposes.

Thus, even if common law principles applied, they would provide no basis for the Trustee to assert any Section 17(a) rights of the customers. Any action brought by the Trustee as "bailee" necessarily is an action to vindicate Weis' own possessory rights—not those of the customers. But Weis, as an entity regulated, rather than

protected, by Section 17(a), has no claim thereunder for interference with its rights, and therefore neither does the Trustee as Weis' successor. Moreover, the common law doctrine does not permit a bailee who cannot satisfy an essential requirement for recovery (*e.g.*, membership in the special class which Section 17(a) benefits) to circumvent such a requirement by asserting that the bailor (*e.g.*, customers) could satisfy it.

Furthermore, any Section 17(a) right is completely outside the scope of the common law doctrine of bailment because it is not a right of action for interference with possession of tangible property, but is a right which is available only to a limited, special class for injury arising out of a relationship to which the statute provides special protection.

In any event, substantive federal securities laws principles preclude implication of any Section 17(a) private right on behalf of Weis (and the Trustee as its successor) as "bailee". A brokerage firm such as Weis, as a mere "bailee" of customer property, is not an intended beneficiary of Section 17(a). Nor is it *necessary* to imply a right of action under Section 17(a) in favor of such a bailee to protect its possessory interests (which are in any event adequately protected by State law), particularly where the bailee's own wrongdoing has led to its alleged injury.

Rule 17(a), F.R.Civ.P., also does not provide any basis for the Trustee to assert customer rights of action for violation of Section 17(a). Rule 17(a), which defines the procedural rights of a "real party in interest", merely provides procedural authority for the Trustee to assert whatever substantive rights he may have to sue as "bailee"—but the Trustee has no such substantive rights.

B. Not being entitled as a purported "bailee" to assert customer Section 17(a) rights, the Trustee is not otherwise entitled to assert those rights. Just as a bankruptcy or Chapter X trustee is not a proper party to assert rights of action belonging only to a particular class of creditors against a third party, *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), the Trustee is not a proper party to assert rights of action of the Weis customers (who are, of course, creditors of Weis to the extent that their claims against Weis are unsatisfied) against Touche Ross.

IV

A. Even if Section 17(a) did create an implied private right of action in brokerage firm customers against accountants, SIPC is not entitled to assert such an implied right as "subrogee" of Weis customers for the payment of whose claims SIPC advanced funds to the Trustee. SIPC's express statutory subrogation rights are set forth in Section 6(f)(1) of SIPA, which provides that SIPC, upon advancing funds for the payment of customer claims against the Weis estate, is subrogated only to those claims *against the estate.* The existence of the limited subrogation rights provided by Section 6(f)(1), in light of the comprehensive statutory scheme of SIPA and the doctrine *expressio unius est exclusio alterius,* means that those rights are exclusive and that SIPC is not subrogated to customers rights of action against third parties.

B. Moreover, SIPC has no equitable subrogation rights here. Once customers have been compensated by SIPC for their losses in accordance with SIPA, it is unnecessary, in order to effectuate the Congressional purpose of providing protection to customers, to imply a private right of action under Section 17(a) to recover those losses, either on behalf of the customers or on behalf of SIPC as subrogee. The only purpose of implying such a right of action and recognizing SIPC's subrogation thereto would be to benefit SIPC, not the customers. The result would be to transfer from SIPC (and brokerage firms

generally that are required to contribute to the "SIPC fund") to a third party such as Touche Ross the burden of providing the financial protection to customers that Congress created SIPC in order to provide. Congress, by enacting SIPA and creating the "SIPC fund", imposed the risks of brokerage firm failure on the brokerage industry generally, thereby creating an incentive for SIPC and the industry to perform their responsibilities diligently. Shifting that risk from SIPC to accountants eliminates those incentives, thereby undermining the statutory purposes. Touche Ross will not be "unjustly enriched" should SIPC, and not Touche Ross, ultimately bear the burden of providing the protection to customers that SIPC was created by Congress in order to provide, and it is not "necessary" to shift that burden from SIPC to Touche Ross in order to effectuate Congress' goals.

In addition, Touche Ross—which will be required under common law principles to pay to the Weis estate any damages proximately caused by its negligence and malpractice—receives no "windfall benefit" even if SIPC (which is subrogated to customer claims against that estate) cannot sue here as subrogee. Furthermore, there is no Congressional intent that third parties such as Touche Ross be liable for the damages here sought, or that SIPC be permitted to recoup from third parties the funds it has advanced for customer claims.

ARGUMENT

I

In Light Of The Statutory Scheme Of The 1934 Act, Which Provides In Section 18(a) A Limited Express Remedy For Misstatements In Section 17(a) Reports, Section 17(a) Does Not Create Any Implied Private Right Of Action For Damages For Such Misstatements, And The Court Of Appeals Majority Erred In Holding To The Contrary

As shown hereinafter, the pertinent statutory scheme includes Section 17(a) of the 1934 Act, which is one of the reporting provisions thereof and requires broker-dealers to file reports prescribed by the SEC, and Section 18(a), which provides to certain purchasers and sellers the only express private damage remedy for misstatements in Section 17(a) reports. However, neither the Trustee, nor SIPC, nor any Weis customer whose claims they purport to assert, is within the purchaser-seller class to which Section 18(a) provides a remedy, and the Trustee and SIPC do not even purport to sue thereunder. Instead, they proceed on the theory that Section 17(a) itself provides for them an implied private right of action for damages for misstatements in Section 17(a) reports—a theory which the Court of Appeals majority accepted to the extent of holding that Section 17(a) does create such an implied right of action for brokerage firm customers and that the Trustee (as a purported "bailee") and SIPC (as a purported "subrogee") may assert that implied right.

However, as also shown hereinafter, the statutory scheme— with its express and limited damage remedy in Section 18(a)—precludes the implication of any additional private right of action for damages from Section 17(a), and the Court of Appeals majority erred in holding to the contrary. As the Court of Appeals majority failed to

recognize, but as Judge Mulligan in dissent clearly understood, the presence of Section 18(a) in the statutory scheme means that

> (i) it is inappropriate to rely here upon the factors set forth in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), which were enumerated by this Court for determining "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added); and
>
> (ii) the controlling authorities are such decisions as *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("*Amtrak*"), and *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975), which establish the principle that, absent clear contrary evidence of legislative intent, a remedy is not to be implied from a statutory provision for which a limited express remedy already is provided, and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), which recognizes that it is improper to imply broader remedies under the 1934 Act than the express statutory remedies specifically provided therein.

Moreover, even assuming that reliance upon a *Cort* v. *Ash* analysis were appropriate here, the Court of Appeals majority erred in its analysis of the applicable factors—including the "necessity" factor made a part of any such analysis by *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25-26 (1977). Furthermore, the Court of Appeals majority improperly relied upon *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). Finally, the Court of Appeals majority ignored the pertinent policy considerations which, to the extent that they may appropriately be considered, militate strongly against implying a right of action under Section 17(a).

A. The Pertinent Statutes And Rules: The Reporting Requirements Of Section 17(a) And Rule 17a-5, The Other Reporting Sections, And The Limited Express Private Right of Action Provided In Section 18(a) For Damages Resulting From Misstatements In Reports.

As this Court recently has emphasized in cases arising under the 1934 Act, "[t]he starting point in every case involving the construction of a statute is the language itself". *International Brotherhood of Teamsters* v. *Daniel*, —U.S.—, 47 U.S.L.W. 4135, 4136 (Jan. 16, 1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *Piper* v. *Chris-Craft Industries, Inc., supra*, 430 U.S. at 24; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976); *Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 756 (Powell, J., concurring). Here, the pertinent statutory language is found in the reporting provisions of Section 17(a), in the other reporting provisions of the 1934 Act, and in Section 18(a), and must be interpreted in light of the principle repeatedly emphasized by this Court that "'*the interdependence of the various sections of the securities laws* is certainly a relevant factor in any interpretation of the language Congress has chosen . . . .'" (emphasis added). *Ernst & Ernst* v. *Hochfelder, supra*, 425 U.S. at 206, *quoting Securities & Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969). *See also Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 727-730.

1. The Reporting Requirements Of Section 17(a) And Rule 17a-5.—Section 17(a), as in effect during 1972 when Touche Ross is alleged to have audited and certified the 1972 Weis financial reports, required broker-dealers such as Weis to "make such reports, as the [SEC] by its rules and regulations may prescribe". 15 U.S.C. §78q(a)

(1972).[13] Section 17(a) was implemented by SEC Rule 17a-5. 17 C.F.R. §240.17a-5 (1972). Rule 17a-5(a)(2) required that broker-dealers "file reports of financial condition containing the information required by Form X-17A-5 . . . within each calendar year". Rule 17a-5(c)(1) also provided that a broker-dealer "may file in lieu of the [Form X-17A-5] report required by [paragraph (a)] a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member".[14]

2. THE OTHER REPORTING PROVISIONS.—Section 17(a) is only one of the sections of the 1934 Act that require the filing of "reports" or similar material. Other such provisions are found in Sections 12(b)(1), 13(a), 13(d), 13(f) and 15(d). 15 U.S.C. §§78*l*(b)(1), 78m(a), 78m(d), 78m(f), 78o(d).[15] The reporting

[13] Section 17(a) as in effect in 1972 is set forth in the appendix annexed to this brief and provided as follows:

"(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section [15] of this [Act], shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. §78q(a) (1972).

Section 17(a) was substantially amended in 1975. *See* Securities Acts Amendments of 1975, Pub. L. No. 94-29, §14, 89 Stat. 137 (1975). However, even after the 1975 amendments, present Section 17(a)(1) contains essentially the provisions of the 1972 version from which the Court of Appeals majority derived its implied private right of action in favor of brokerage firm customers, *viz.*, the requirement that broker-dealers "make and disseminate such reports as the [SEC], by rule, prescribes". 15 U.S.C. §78q(a)(1).

[14] The 1972 version of Rule 17a-5 is set forth in full in the appendix annexed to this brief. Rule 17a-5, which also has been substantially amended since 1972, continues in Rule 17a-5(a)(2) to require filings by broker-dealers of Form X-17A-5 and to permit in Rule 17a-5(a)(4) the submission in lieu thereof of comparable data filed with a national securities exchange.

[15] Section 12(b)(1) requires every "issuer" of a security "registered on a national securities exchange" to file an "application

requirements of Section 17(a) and of the other sections of the 1934 Act and the rules implementing those sections are recognized to be interrelated, as shown, for example, by the express provision of Rule 17a-5(c)(2), as in effect in 1972, that in certain situations the SEC "will accept any statement of . . . financial condition filed pursuant to sections 13 or 15(d) of the [1934 Act] . . . and the rules and regulations promulgated thereunder as a filing pursuant to [Rule 17a-5]". Compare present Rule 17a-5(k), 17 C.F.R. 240.17a-5(k) (1977).

3. THE EXPRESS REMEDY IN SECTION 18(a) FOR REPORTING MISSTATEMENTS, INCLUDING MISSTATEMENTS IN SECTION 17(a) REPORTS.— The reporting provisions of the 1934 Act, including Section 17(a), do not themselves contain any express private remedy for misstatments in reports filed pursuant thereto. However, Section 18, 15 U.S.C. §78r, which is entitled "Liability for Misleading Statements", provides the express private remedy for such misstatements. That remedy is set forth in the carefully limited language of Section 18(a), and only permits certain *purchasers and sellers of securities* to recover damages, as follows:

"(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the 1934 Act] or any rule or regulation thereunder . . . , which statement was . . . false or misleading with respect to any material fact,

[which] shall contain . . . [s]uch information" as the SEC may require. 15 U.S.C. §78*l*(b)(1). Section 13(a) requires every "issuer" of a registered security to file "such information and documents" and "such annual . . . and . . . quarterly reports" as the SEC may prescribe. 15 U.S.C. §78m(a). Section 13(d) requires any person becoming the beneficial owner of more than 5% of certain classes of equity securities to file "a statement containing such . . . information" as the SEC may prescribe. 15 U.S.C. §78m(d). Section 13(f) requires every "institutional investment manager" to file "reports" as the SEC may prescribe. 15 U.S.C. §78m(f). Section 15(d) requires certain issuers to file "supplementary and periodic information, documents, and reports" as may be required by Section 13. 15 U.S.C. §78o(d).

> shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have *purchased or sold a security* at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading" (emphasis added). 15 U.S.C. §78r(a).[16]

In providing a remedy for misstatements "in any . . . report, or document filed pursuant to [the 1934 Act] or any rule or regulation thereunder", Section 18(a) necessarily covers reports filed pursuant to any of the reporting provisions, including Section 17(a) and Rule 17a-5. It is impossible to read Section 18(a) as not applying to Section 17(a), in light of the inescapable fact that both sections use the very same word "report"—Section 17(a) in providing that broker-dealers shall "make . . . reports" and Section 18(a) in providing liability for misstatements in "any . . . report". The Court of Appeals majority (*e.g.*, A.201), Judge Mulligan in dissent (*e.g.*, A.211-A.212) and the District Court (A.178-A.179), all clearly understood that Section 18(a) does apply to Section 17(a) reports—an understanding also reflected in numerous other decisions[17] and in the legislative history of the 1934

[16] Section 18 was not amended in 1975, and is the same now as in 1972.

[17] For example, as noted by Judge Mulligan's dissent (A.215 n.5), the District Court has upheld a Section 18(a) claim against Touche Ross by a plaintiff bank which allegedly purchased securities of Weis in reliance upon the very Section 17(a) reports upon which the Trustee and SIPC here rely. *Exchange National Bank* v. *Touche Ross & Co.* (S.D.N.Y. 75 Civ. 916); *see Exchange National Bank* v. *Touche Ross & Co.*, 544 F.2d 1126, 1127-1128 (2d Cir. 1976). *See also, e.g., Cramer* v. *General Telephone & Electronics Corp.*, 582 F.2d 259, 269 (3d Cir. 1978) (citing Section 17(a) as "one of several statutory provisions requiring the filing of . . . documents, and reports with the [SEC]", and holding that "Section 18 . . . provides a civil remedy for damages resulting from . . . a misleading statement in a document or report filed with the SEC"), *petition for cert. filed*, 47 U.S.L.W. 3392 (Nov. 27, 1978) (No. 78-853); *In re Penn Central*

Act.[18]

Securities Litigation, 347 F.Supp. 1327, 1340 (E.D. Pa. 1972) ("Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the [1934] Act [including §17(a)]"), *decision as to Section 13(a) adhered to on reargument*, 357 F.Supp. 869 (E.D. Pa. 1973), *aff'd*, 494 F.2d 528, 539-540 (3d Cir. 1974) (Section 18(a) applies to "a false statement in a document filed under any other section"); *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213, 214 (S.D.N.Y. 1975) (Section 18 applies to "a false or misleading statement in a document filed pursuant to the [1934 Act]"), *aff'd by oral opinion*, 538 F.2d 312 (2d Cir. 1976); *Meer* v. *United Brands Co.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,648 at 90,213 (S.D.N.Y. 1976) ("Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements"); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973) (citing Section 17(a) as "one of a number of provisions that require the filing of . . . reports" and holding that "[c]ivil liability for failure to comply with [all] these sections is provided in Section 18(a)").

[18] For example, Senator Fletcher, Chairman of the Senate Committee on Banking and Currency, in introducing the original bill (S. 2693) which led to the passage of the 1934 Act, submitted a digest which stated that "Section 17 [of the bill, which became Section 18 of the 1934 Act] imposes civil liability for false or misleading statements in *any of the reports* or records required under this act" (emphasis added). 78 CONG. REC. 2271 (1934). Moreover, Richard Whitney, President of the New York Stock Exchange, submitted to the Senate and House committees considering the bill a statement expressing the awareness that Section 18 would impose liability upon "persons transacting business in securities" (*i.e.*, upon broker-dealers required to file reports under Section 17(a)) for misstatements in such reports, as follows:

> "Section 17 of the bill [Section 18 of the 1934 Act] deals with the liability of any person who shall make or be responsible for making any statement in any report or document filed with the . . . Commission, which was 'in the light of circumstances under which it was made, false or misleading in respect of any matter sufficiently important to influence the judgment of an average investor' . . . . In view of the unlimited character of the information which the . . . Commission has the right to require exchanges and *persons transacting business in securities*, as well as all corporations listed on a national exchange, to file with it, it will be humanly impossible to determine what facts may, in retrospect, be deemed to be sufficiently important to influence the judgment of an average investor" (emphasis added). *See Hearings Before the Senate Comm. on Banking and Currency*, 73rd Cong. 2d Sess. 6638 (1934). *See also Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73rd Cong., 2d Sess. 226 (1934).

B. The Trustee And SIPC Cannot State A Claim For Relief Under Section 18(a) And Therefore Have No Federal Claims Unless Section 17(a) Provides An Implied Private Right Of Action For Damages.

As the Trustee and SIPC concede, and as both the District Court and the Court of Appeals recognized (A.178, A.200-A.201, A.215-A.216 (dissent)), neither the Trustee nor SIPC, nor Weis' customers whose claims they purport to assert here, can meet the purchaser-seller requirement of Section 18(a), and therefore the Trustee and SIPC cannot (and do not) assert any entitlement to the express remedy of Section 18(a), either in their own right or in the right of the customers. Consequently, in order to find some purported basis in the 1934 Act to "federalize" their essentially common law claims for accountants' negligence and malpractice, the Trustee and SIPC argue that an implied right of action which they may assert is created by Section 17(a) itself. That argument, as shown hereinafter, misconceives the statutory scheme and the controlling decisions, was erroneously accepted by the Court of Appeals majority, and was properly rejected by the District Court and by Judge Mulligan in dissent.

C. In Light Of The Statutory Scheme Of The 1934 Act, And The Express Remedy Provided By Section 18(a), Section 17(a) Does Not Create Any Implied Private Right Of Action For Damages.

In considering whether Section 17(a) creates an implied right of action for damages, it is of overriding significance that Section 18(a) already provides an express private damage remedy for violations of Section 17(a). The analysis required in such circumstances by this Court's controlling decisions demonstrates that the existence of Section 18(a), with its carefully limited express remedy, precludes the implication of a separate, and broader, remedy from the provisions of Section 17(a)

itself, and that such implication would seriously distort the statutory scheme of the 1934 Act. It also shows that Judge Mulligan was correct when he stated in dissent that the "majority's holding . . . goes beyond statutory construction [and] amounts instead to judicial legislation" (A.216).

1. THE EXISTENCE OF SECTION 18(a) MEANS THAT RELIANCE UPON *Cort* v. *Ash* IS NOT APPROPRIATE HERE.—The Court of Appeals majority based its holding that Section 17(a) creates implied private rights of action in brokerage firm customers upon a purported consideration of the factors set forth in *Cort* v. *Ash, supra* (A.195-A.200). However, as Judge Mulligan noted in his dissent (A.210, A.212), the *Cort* v. *Ash* factors were enumerated by this Court for the purpose of determining "whether a private remedy is implicit in a statute *not expressly providing one*" (exphasis added). 422 U.S. at 78. *See also, e.g., Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25, 37 ("[W]e must consider whether §14(e), which is *entirely silent as to private remedies,* permits this Court to read into the statute a damages remedy . . . . [I]n *Cort* v. *Ash* . . . . the Court identified four factors as 'relevant' in determining whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added)).

Therefore, in light of the express remedy already provided in Section 18(a) for misstatements in 17(a) reports, this case does not involve a situation where (as in *Cort* v. *Ash)* a remedy is sought to be implied for violation of a statute as to which no express private remedy whatsoever is provided.[19] It involves instead a statutory

[19] *Cf.* Section 206 of the Investment Advisers Act, 15 U.S.C. §80b-6, which is a statutory provision for which no express remedy whatsover is provided and is the provision involved in *Lewis* v. *Transamerica Corp.,* 575 F.2d 237 (9th Cir.), *cert. granted sub nom. Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis,* 99 S.Ct. 348 (1978) (No. 77-1645) (*see also* A.214 n.4).

scheme in which Congress already expressly has provided both its desired statutory requirement (Section 17(a)) and the sole private remedy (Section 18(a)) it thought necessary and appropriate for violations of that requirement.[20] Consequently, *Cort* v. *Ash* does not set forth the appropriate analysis here. Rather, it is this Court's decisions in *Amtrak, supra, Securities Investor Protection Corp.* v. *Barbour, supra,* and *Blue Chip Stamps* v. *Manor Drug Stores, supra,* which deal directly with the question of implying remedies from statutes already containing express remedies, that set forth the appropriate analysis.

2. THE CONTROLLING DECISIONS HERE ARE *Amtrak, Barbour* AND *Blue Chip Stamps,* WHICH COMPEL THE CONCLUSIONS THAT CONGRESS INTENDED SECTION 18(a) TO PROVIDE THE EXCLUSIVE DAMAGE REMEDY FOR MISSTATEMENTS IN SECTION 17(a) REPORTS, AND THAT NO ADDITIONAL OR BROADER REMEDY MAY BE IMPLIED FROM SECTION 17(a) ITSELF.—The express, and carefully limited, damage remedy provided by Section 18(a) for misstatements in Section 17(a) reports necessarily reflects a Congressional intention that a damage remedy for such misstatements would be available only as provided in Section 18(a)—*i.e.,* where a person purchased or sold a security in reliance thereon—and that no other damage remedy for such misstatements (*e.g.,* a damage remedy for brokerage firm customers who neither purchased nor

[20] This Court has recognized the clear dichotomy between sections of the 1934 Act for which no express remedy whatsoever is provided, and sections of the 1934 Act for which Section 18(a) does provide an express remedy. *E.g., Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 24-25 ("Section 14(e) . . . makes no provision whatever for a private cause of action, such as those explicitly provided in other sections of the 1933 and 1934 Acts. *E.g.,* §§ . . . 18 . . . of the 1934 Act"); *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 730 (noting "the contrast between the provisions of Rule 10b-5 [with its lack of express remedy] and the numerous carefully drawn express civil remedies [including specifically Section 18 of the 1934 Act] provided in the Acts of both 1933 and 1934").

sold securities in reliance thereon) was intended or could be implied. As Judge Mulligan's dissent observes, "Section 18(a) follows upon the heels of section 17" and "[i]ts subject matter covers reports . . . filed pursuant to the [19]34 Act", and thus *"common sense would dictate* . . . that section 18(a) expressly provides *the sole private remedy which Congress intended* to be available for a violation of section 17(a) and the other reporting sections" (emphasis added) (A.211).

The "common sense" conclusion that Congress intended Section 18(a) to be the exclusive damage remedy for misstatements in Section 17(a) reports is also required, as Judge Mulligan further recognized (A.213-A.214), by decisions of this Court explicitly directing that, where a remedy is sought to be implied from a statutory provision for which a limited express remedy already is provided, the doctrine *expressio unius est exclusio alterius* is to be applied. For example, in *Amtrak, supra,* this Court held that no private right of action could be implied under the Amtrak Act in favor of railroad passengers because Section 307(a) thereof granted an express remedy only to a limited class of persons (*viz.,* the Attorney General and certain railroad employees) that did not include such passengers, and because the implication of a private right in favor of other persons therefore would be inconsistent with the statutory scheme. Noting the compelling force of the *expressio unius* doctrine, the Court unequivocally directed that

> "*when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies.* 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.' . . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.*

> Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created in §307(a) are the exclusive means to enforce the duties and obligations imposed by the Act" (emphasis added). 414 U.S. at 458.

Similarly, in *Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 419, in holding that the express statutory grant to the SEC of a right to seek injunctive relief to enforce duties under SIPA precluded any implied right in others to seek similar relief, this Court reiterated the "observation [in *Amtrak*] that express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature".

The *expressio unius* doctrine that this Court found compelling in *Amtrak* and *Barbour* is equally compelling here to require a holding that, in light of the limited express remedy in Section 18(a), Section 17(a) itself creates no additional implied private right of action. To paraphrase the language of *Amtrak,* "[s]ince the [1934] Act creates . . . a private cause of action only under very limited circumstances [*i.e.,* the circumstances set forth in Section 18(a)], this maxim [*expressio unius est exclusio alterius*] would clearly compel the conclusion that the remedies created in [Section 18(a)] are the exclusive means to enforce the [reporting] duties and obligations imposed by [Section 17(a) and the other reporting provisions]". *See* 414 U.S. at 458.

While this Court did state in *Amtrak* that the *expressio unius* doctrine must "yield to clear contrary evidence of legislative intent", it then went on to examine the pertinent legislative history and to conclude that there was "no [such] contrary indication in any of the hearings or committee reports". 414 U.S. at 458, 461.[21] The same conclusion is unavoidable here because, as shown hereinafter (pp. 46-47, *infra*), the legislative history of the 1934 Act does not contain the "clear contrary evidence of legislative intent" to create an implied Section 17(a) remedy that *Amtrak* held to be necessary to overcome the application of the *expressio unius* doctrine otherwise required by the existence of Section 18(a). Indeed, even the Court of Appeals majority conceded that there is "no indication, either in the statute itself or in its legislative history, of any congressional intent . . . to create a private remedy under section 17", and stated that "[t]he legislative history of the section is mute on the issue" (A.198; *see also* A.214 (dissent); A.178 (District Court)). Consequently, *Amtrak* and *Barbour* require a holding that, in light of the existence of the express remedy in Section 18(a), Section 17(a) does not create any additional implied remedy.

Moreover, the implication under Section 17(a) of an implied right of action in addition to—and necessarily broader (in that it is not limited by the purchaser-seller requirement) than—the express remedy of Section 18(a) also directly conflicts with *Blue Chip Stamps* v. *Manor Drug Stores, supra,* where this Court emphasized the impropriety of implying a broader remedy for violations of the 1934 Act than the statutory remedies already expressly provided therefor.[22] In *Blue Chip Stamps,* in

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[21] *Cf. Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 201 ("mindful that the language of a statute controls when sufficiently clear in its context . . . further inquiry [*i.e.,* into legislative history] may be unnecessary").

[22] As the District Court here noted, the Trustee and SIPC "are obliged to argue that there is an implied private claim under Section 17 [not limited by the purchaser-seller requirement and therefore] *broader* than the claim *expressly* created by Section 18 . . . because they did not purchase nor sell any security . . . and thus cannot state a claim under Section 18" (A.178).

upholding the purchaser-seller requirement for claims under Section 10(b) of the 1934 Act and Rule 10b-5, this Court noted that "[t]he principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of §10(b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities", and then, specifically addressing itself to Section 18(a) of the 1934 Act, stated that

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . .' *It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action"* (emphasis added). 421 U.S. at 735-736.

Of course, what *Blue Chip Stamps* found "anomalous" was any imputed Congressional intent to permit a remedy for the "judicially implied cause of action" for violation of Section 10(b) and Rule 10b-5 that would be more broadly applicable (*i.e.,* not limited by the purchaser-seller requirement) than the remedies actually specified in "comparable express causes of action" in provisions such as Section 18 (which are expressly limited by the purchaser-seller requirement). However, as Judge Mulligan's dissent notes (A.215), the "anomalous" intention that *Blue Chip Stamps* said could not properly be imputed to Congress "is precisely what the majority is imputing to Congress in this case" by its holding that there is an implied right of action under Section 17(a) broader than (*i.e.,* in favor of brokerage firm customers who do not meet the purchaser-seller requirement of) the express

remedy under Section 18(a). Indeed, to imply a right of action under Section 17(a) broader than the express remedy under Section 18(a) is even *more* "anomalous" than to imply such a broader right under Section 10(b), because the express Section 18(a) remedy deals with circumstances that are, instead of being simply "comparable" to those dealt with by any remedy arguably to be implied from Section 17(a), *precisely the same* circumstances, *viz.,* misstatements in Section 17(a) reports.

Significantly, *Blue Chips Stamps* also emphasized—in finding, on the basis of the "[a]vailable evidence from the texts of the 1933 and 1934 Acts as to the Congressional scheme", a predominant pattern to grant private remedies to those damaged in the purchase or sale of securities (citing Sections 11(a) and 12 of the 1933 Act and Sections 9(e) and 18(a) of the 1934 Act), 421 U.S. 733-736—that "[w]hen Congress wished [in contrast to that pattern] to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly" (citing Section 16(b) of the 1934 Act; *see also* Section 20, 15 U.S.C. §78t, imposing liability on "controlling persons"), 421 U.S. at 734. As Judge Mulligan noted in dissent, the fact that Congress "had little trouble" in expressly providing any desired remedies to non-purchasers or non-sellers "reinforces the conclusion that *the framing of the section 18(a) remedy in terms of purchasers and sellers of securities to the exclusion of customers of broker-dealers was an intentional congressional limitation* on the class for whom a private action would be available in the event of a Section 17(a) violation" (emphasis added) (A.214-A.215).

* * *

Thus, *Amtrak, Barbour* and *Blue Chip Stamps* are the controlling authorities and compel a contrary result to that

reached by the Court of Appeals majority. As aptly summed up by Judge Mulligan in dissent,

> "*Amtrak, Barbour* and *Blue Chip* compel the conclusion that the omission [of a remedy for misstatements in Section 17(a) reports in favor of brokerage firm customers] was studied and that the implication of a damage action against accountants under this section is totally unwarranted. *The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy provided [in Section 18(a)] was designed to exclude the class which is here seeking monetary relief*" (emphasis added) (A.215-A.216).

3. THE LEGISLATIVE HISTORY OF SECTION 17(a) DOES NOT SUPPORT AN IMPLIED RIGHT OF ACTION THEREUNDER.—As already noted (pp. 42-43, *supra*), and as recognized by the Court of Appeals majority (A.198), the pertinent legislative history simply does not contain any evidence whatsoever that Congress intended that Section 17(a) create any implied private right of action. It also contains no evidence that Congress intended that Section 18(a) be other than the exclusive remedy for violations of Section 17(a).[23]

The Congressional reports with respect to the bills that became the 1934 Act make no mention of a private right of action under Section 17 and refer only to administrative enforcement by the SEC. *See* S. REP. NO. 792, 73rd Cong., 2d Sess. 21 (1934); H.R. REP. NO. 1383, 73rd Cong., 2d Sess. 25 (1934); S. DOC. NO. 185, 73rd Cong.,

[23] *Cf. In re Penn Central Securities Litigation*, 494 F.2d 528, 540 (3d Cir. 1974) ("[w]e have not been cited to any language or to any history in the 1934 Act which indicates that Congress intended to extend the protection offered by §13(a) beyond the class of purchasers or sellers [referred to in Section 18(a)]").

2d Sess. 17 (Conf. Rep.) (1934). Commissioner Landis described Section 17 (Section 16 of the bill) as a provision that "puts the accounting of members of the exchanges, dealing in over-the-counter markets, [and] brokers who deal with members of the exchange under the control of the [SEC]", but no one involved in the committee hearings suggested that there could be any private right of action thereunder. *Hearings on H. R. 7852 and H. R. 8720 Before the House Comm. on Interstate and Foreign Commerce ("Stock Exchange Regulations")*, 73rd Cong., 2d Sess. 22, 225-226, 262, 536, 666, 670, 750, 804 (1934). Although criticism of Section 17 centered on the expense of administrative enforcement by the SEC, *see, e.g., id.* at 226, 536, 666, at no time was it proposed that the expense of public enforcement could be alleviated by permitting private suits under Section 17.

Thus, there is lacking here the "clear contrary evidence of legislative intent" which, under *Amtrak*, is necessary to overcome the presumption that the express remedy in Section 18(a) was intended by Congress to be the exclusive remedy for misstatements in Section 17(a) reports.[24] Such a presumption is particularly appropriate here because, while there is a total lack of any legislative history showing a Congressional intention to create in Section 17(a) an implied private right of action, the legislative history does reflect a Congressional understanding that the express Section 18(a) remedy was to apply to misstatements in Section 17(a) reports (*see* p. 37 n.18, *supra*).

[24] Even with respect to the 1975 amendments to the 1934 Act, which came during a period when a number of brokerage firms had collapsed, their customers had suffered damages as a result, and SIPC had been required to advance substantial funds for the payment of their claims, there was no suggestion in the legislative history that any private damage remedies were or should be provided for such customers. That legislative history is detailed in the brief *amicus curiae* (at 11-13) of the American Institute of Certified Public Accountants.

4. THE IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17(a) WOULD BE CONTRARY TO THE PURPOSES OF THE PURCHASER-SELLER REQUIREMENT OF SECTION 18(a), AND IS NOT REQUIRED BY ANY "FLEXIBLE" CONSTRUCTION OR "REMEDIAL" PURPOSE OF THE 1934 ACT—*Blue Chip Stamps* recognized that an important purpose of the purchaser-seller requirement in Section 18(a), and in the other sections providing remedies to purchasers and sellers, is to require a direct and readily demonstrable connection between an alleged statutory violation and the plaintiff's alleged injury, and to exclude claims where that connection is speculative or incapable of being concretely demonstrated. Noting the SEC's own observation "that the effect, if any, of a deceptive practice on someone who has neither purchased nor sold securities may be more difficult to demonstrate than is the effect on a purchaser or seller", *Blue Chip Stamps* emphasized the speculative and unreliable nature of the proof that would be permissible if the purchaser-seller requirement were eliminated and a non-purchaser or non-seller were allowed to assert what might have been or what could have occurred but for the defendant's violation. 421 U.S. at 742-746.

The purported Section 17(a) claims of the Weis customers, which the Court of Appeals majority would permit the Trustee and SIPC to assert here, are exactly the kind of speculative and unreliable claims that *Blue Chip Stamps* held are, and should be, excluded by the purchaser-seller requirement. The claims of the Weis customers—who number "over 34,000" (A.25-A.31 [¶¶ 52, 55, 56, 62, 67, 71, 74, 75, 79, 82, 83]) — are not based upon injury suffered as part of an "objectively demonstrable" purchase or sale of securities, but rather upon alleged damages suffered as the result of inaction by the SEC, SIPC, the Exchange, Weis, its Board of Directors and the

customers. According to the Trustee and SIPC, the customers were injured, and Touche Ross is obligated to make good their injuries, because they left property at Weis, because Weis collapsed and because, but for the misstatements in the Weis financial statements,

> "Weis' 1973 forced liquidation under [SIPA] *would not have* become necessary, and most if not all of Weis' assets and its good will as a going concern *could have been* preserved by a number of means . . . . Moreover, *if* a liquidation of Weis *had been necessary* as the result of . . . truthful reporting, such liquidation *could have occurred* at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later" (emphasis added) (A.8-A.9 [¶11]).

In other words, the Trustee and SIPC here talk of what "would not have become necessary", what "could have been" and what "could have occurred", making clear that the customer claims they assert here are, just as the claims in *Blue Chip Stamps* were, based not upon actions that were in fact taken, but rather upon failures to take action and speculative allegations concerning what actions might have been taken and the consequences that might have resulted therefrom. Trial of such claims would hinge on speculative and subjective testimony and would raise precisely the problem that *Blue Chip Stamps* says must be avoided. *Cf. Abrahamson* v. *Fleschner,* 568 F.2d 862, 884 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978) ("the underlying concern in *Blue Chip,* though standing was involved, was . . . , perhaps, the sheer inability to disprove what a plaintiff says he *would have* done if he had but known the truth") (Gurfein, C.J., dissenting).[25]

[25] It is also significant that any injury here resulted directly from waste and mismanagement by Weis' officers of the assets held by Weis—waste and mismanagement which is expressly alleged to have

Thus, the salutary purpose of eliminating speculative and unreliable claims that led this Court in *Blue Chip Stamps* to uphold the purchaser-seller requirement for Section 10(b) actions also compels the conclusion that the Trustee and SIPC cannot be permitted to avoid the purchaser-seller requirement of Section 18(a) simply by asserting a purported implied right of action under Section 17(a).[26]

Moreover, the purchaser-seller requirement is not to be avoided by facile assertions about "flexible" construction or "remedial" purposes of the 1934 Act. *Blue Chip Stamps* expressly rejected the view that the purchaser-seller requirement is inconsistent with the principle that the provisions of the 1934 Act should be flexibly construed, and concluded that "[h]owever *flexibly* we may construe the language of both provisions, nothing in such construction militates against the [purchaser-seller] rule" (emphasis added). 421 U.S. at 749. And only last Term, in *Securities & Exchange Commission* v. *Sloan*, 436 U.S. 103, 115-116 (1978), this Court emphasized that reference to the generalized "remedial purposes" of the 1934 Act does not justify reading a particular provision "more broadly than its language and the statutory scheme reasonably permit", even assuming that a "totally satisfactory remedy" therefore would not be available "in every instance in which the [SEC] would like such a remedy". *See also Ernst & Ernst* v. *Hochfelder, supra*, 425 U.S. at 200 (rejecting argument "that the 'remedial purposes' of the Acts demand a construction of § 10(b) that embraces negligence as a standard of liability").[27]

5. NUMEROUS RECENT DECISIONS, INCLUDING TWO DECISIONS OF THE THIRD CIRCUIT, RECOGNIZE THAT THE FOREGOING PRINCIPLES PRECLUDE THE IMPLICATION OF PRIVATE RIGHTS OF ACTION UNDER REPORTING PROVISIONS SUCH AS SECTION 17(a).—Two recent Third Circuit decisions, as well as numerous district court decisions, hold that, in light of the foregoing principles and the statutory scheme that includes in Section 18(a) an express remedy for misstatements in reports required by other provisions of the 1934 Act, Section 18(a) is the exclusive remedy for such misstatements and no other remedies may be implied from the reporting provisions themselves. Those decisions—like Judge Mulligan's dissent here—recognize that implication of additional implied remedies from the reporting provisions themselves would ignore the intention of Congress and the controlling decisions of this Court, and would distort the statutory scheme.

occurred here (*e.g.*, A.20 [¶31h])—and at most resulted only indirectly or remotely from any misstatements in the 1972 Weis financial reports. This Court has recognized that the purchaser-seller requirement found in such provisions as Section 18(a) limits the class of persons who may bring private actions to those whose injuries (*viz.*, purchases of securities at prices inflated, or sales of securities at prices depressed, by misstatements) result directly and demonstrably from violations of the 1934 Act and not from waste and mismanagement allegedly made possible by such violations. *Cf. Santa Fe Industries, Inc.* v. *Green, supra*, 430 U.S. at 479 ("Congress . . . did not seek to regulate transactions which constitute no more than internal corporate mismanagement"); *Hoover* v. *Allen*, 241 F.Supp. 213, 225 (S.D.N.Y. 1965); *Bio-Medical Sciences, Inc.* v. *Weinstein*, 407 F.Supp. 970, 974 (S.D.N.Y. 1976).

[26] *Blue Chip Stamps* also referred to another, separate aspect of the "vexatious litigation" which would flow from elimination of the purchaser-seller requirement, *viz.*, that it would increase the incidence of claims which, although they had little objective chance of success, would permit undue use of the liberal federal discovery rules and taking up of others' time, and thereby would add an "*in terrorem* increment [to] the settlement value". 421 U.S. at 740-743.

[27] *See also Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.*, 417 U.S. 703, 717 n.13 (1974) ("[T]he statutory design [of the securities statutes] has not been effectuated through the indiscriminate provision of causes of action to every citizen. Rather, these statutes create specifically defined legal duties to particular plaintiffs and vest the appropriate causes of action in them alone").

For example, in *In re Penn Central Securities Litigation, supra,* plaintiffs alleged that reports filed under Section 13(a) of 1934 Act were misleading and asserted (because they were not purchasers or sellers of securities and thus did not fall within Section 18(a)) that they had an implied right of action for damages under Section 13(a) itself. The District Court dismissed the Section 13(a) claims. 347 F.Supp. 1327 (E.D. Pa. 1972), *decision as to Section 13(a) adhered to on reargument,* 357 F.Supp. 869 (E.D. Pa. 1973). It pointed out that

> "Section 13 is one of a number of provisions [of the 1934 Act] that require the filing of . . . reports. *See* §§ . . . 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the [1934] Act", 347 F.Supp. at 1340,

and then, although recognizing that "Courts have implied civil remedies for violations of [certain] provisions of the [1934 Act]", held that Section 18(a) "is the exclusive remedy for violation of § 13(a)" because

> "when the legislature has specifically authorized or withheld the right to recover damages arising by reason of a violation of a statute, an implied right of action does not exist. . . . Where Congress has specifically authorized a remedy for violation of an act, the courts should not nullify the congressional scheme by implying a right of action on behalf of those not otherwise entitled to recover. . . . Given the express civil remedy for § 13(a) provided by § 18(a), we conclude that § 13(a) does not afford a private right of action", *id.* at 1339-1340.

The Third Circuit affirmed. 494 F.2d 528 (3d Cir. 1974). It emphasized that a contrary holding "would result in the elimination of the purchaser-seller requirement for violations of § 13(a)", and that "the same considerations

[which require application of the purchaser-seller requirement to section 10(b)] also apply to [require denial of] the contention . . . that we should imply a private right of action in section 13(a) to avoid the purchaser-seller requirement of section 18". *Id.* at 540-541.

More recently, in *Cramer* v. *General Telephone & Electronics Corp.,* 582 F.2d 259, 269 (3d Cir. 1978), *petition for cert. filed,* 47 U.S.L.W. 3392 (Nov. 27, 1978) (No. 78-853), the Third Circuit again upheld dismissal of a claim under Section 13(a) where the plaintiff was unable to satisfy the requirements of Section 18, noting that

> "Section 13 is one of several statutory provisions requiring the filing of applications, documents, and reports with the [SEC]. *See also* §§ . . . 17(a) of the Act. . . . Section 18, 15 U.S.C. § 78r, provides a civil remedy for damages resulting from the purchase or sale of a security in reliance upon a misleading statement in a document or report filed with the SEC."

The reasoning and holding of the Third Circuit decisions, and of the numerous district court decisions reaching the same result,[28] are clearly applicable to Sec-

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[28] *See, e.g., Cramer* v. *General Telephone & Electronics,* 443 F.Supp. 516 (E.D. Pa. 1977) (Section 12(b)(1)), *aff'd,* 582 F.2d 259 (3d Cir. 1978), *petition for cert. filed,* 47 U.S.L.W. 3392 (Nov. 27, 1978) (No. 78-853); *DeWitt* v. *American Stock Transfer Co.,* 433 F.Supp. 994, 1004-1005 (S.D.N.Y.) (Sections 13(a) and 15(d)), *modified on other grounds,* 440 F.Supp. 1084 (S.D.N.Y. 1977); *Levy* v. *Johnson,* [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,899 at 91,324 (S.D.N.Y. 1977) (Section 13(a)); *Lewis* v. *Elam,* [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,013 (S.D.N.Y. 1977) (Section 13(a)); *Meer* v. *United Brands Co.,* [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,648 (S.D.N.Y. 1976) (Section 13(a)); *In re Equity Funding Corp. of America Securities Litigation,* 416 F.Supp. 161, 190 (C.D. Cal. 1976) (Section 13(a)); *McLaughlin* v. *Campbell,* 410 F.Supp. 1321, 1325 (D. Mass. 1976) (Section 13(a)); *Myers* v. *American Leisure Time Enterprises, Inc.,* 402 F.Supp. 213 (S.D.N.Y. 1975), *aff'd by oral opinion,* 538

tion 17(a). Section 17(a), like the sections of the 1934 Act involved in those decisions, is a reporting provision, and Section 18(a) is as applicable to misstatements in Section 17(a) reports as it is to reports filed under those other sections.

6. THE COURT OF APPEALS ERRED BECAUSE IT MISAPPREHENDED THE STATUTORY SCHEME, AND BECAUSE IT FAILED TO APPLY THE ANALYSIS REQUIRED BY, AND THEREFORE REACHED A RESULT IN CONFLICT WITH, THIS COURT'S CONTROLLING DECISIONS.—In failing to conclude (as have the other courts to consider the issue) that Section 18(a) provides the exclusive remedy for reporting violations, and in holding that Section 17(a) creates an implied private right of action despite the express Section 18(a) remedy, the Court of Appeals majority misapprehended the statutory scheme of the 1934 Act. Its basic error was its reliance upon the factors held relevant in *Cort* v. *Ash* for "determining whether a private remedy is implicit in a statute *not expressly providing one*", and its consequent failure to apply the analysis required by *Amtrak, Barbour* and *Blue Chip Stamps* to this case, where there already exists an express remedy (Section 18(a)) for violations of the statutory provision (Section 17(a))

F.2d 312 (2d Cir. 1976) (Section 13(d)); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973) (Section 13(a)). There are a few cases which, without analysis, would appear to hold to the contrary and permit a private right of action under one of the provisions of Section 13. In rejecting those cases as meaningful authority, the Third Circuit in *In re Penn Central Securities Litigation, supra*, cited them and described their defects as follows:

> "In re Caesar's Palace Securities Litigation, 360 F.Supp. 366, 388 (S.D.N.Y. 1973) (denying motion to dismiss § 13 claims without discussion of this issue); . . . Kaminsky v. Abrams, 281 F.Supp. 501, 505 (S.D.N.Y. 1968) (accepting possibility of private action under § 13) (dicta); Kroese v. Crawford, '61-'64 CCH Fed.Sec.L. Rep. ¶91,262 (S.D.N.Y. 1963) (denial of motion to dismiss under § 13(a), upholding private right of action, based on unexplicated 'history and purposes of the federal securities laws.')". 494 F.2d at 540 n. 18.

under which an implied remedy is sought. That analysis first requires recognition of the existence of the express remedy of Section 18(a), then consideration of Sections 17(a) and 18(a) in light of the *expressio unius* doctrine and in light of the anomaly of implying a Section 17(a) remedy broader than the express Section 18(a) remedy, and finally application of those considerations to bar an implied remedy under Section 17(a) in the conceded absence of "clear contrary evidence of legislative intent".

However, the Court of Appeals majority instead purported first to analyze Section 17(a), and to determine whether it creates an implied remedy, *without any consideration of Section 18(a)* (A.195-A.200). Only after concluding that there is such an implied remedy did the majority finally give cursory consideration to Section 18(a), and then only to assert that it does not detract from the existence of such a remedy (A.200-A.201). Of course, as *Amtrak, Barbour* and *Blue Chip Stamps* make clear, that approach is based upon the patently erroneous view that Section 18(a) is in no way indicative of the Congressional intent as to whether Section 17(a) creates an implied remedy—a view which the majority acknowledged holding by its statement that "[w]e find no indication . . . *in the statute itself* . . . of any congressional intent either to create a private remedy under Section 17 or to deny one" (emphasis added) (A. 198).

The erroneous failure of the Court of Appeals majority to give proper weight to Section 18(a) resulted from its equally erroneous conclusion that Section 18(a) is irrelevant here because brokerage firm customers are "members of a class peculiarly protected by Section 17" and "are favored wards of Section 17", because the express remedy of Section 18(a) will normally not be available to such customers, and because "[w]e cannot agree that Congress simultaneously sought to protect a class and

deprived the class of the means of protection" (A.196, A.200). In the first place, the Court of Appeals majority clearly overstated in asserting that brokerage firm customers would be "deprived . . . of the means of protection" (A.200) without an implied right of action under Section 17(a). As Judge Mulligan's dissent spells out in detail (A.216-A.221; *see also* pp. 60-63, *infra*), brokerage firm customers have many "protections", including the preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970), both as part of the monitoring system and as a source of funds to pay customer losses, the deterrent effect of criminal and injunctive proceedings, and the availability of state law remedies.

The unavailability of the express Section 18(a) remedy for misstatements in Section 17(a) reports to persons (such as brokerage firm customers) who do not meet the purchaser-seller requirement, but who conceivably might be injured as a result (albeit not a direct and readily demonstrable one — *see* pp. 48-50, *supra*) of such misstatements simply reflects a Congressional intention that no *federal* damage remedy be available to them, and is consistent with the fact that the 1934 Act was never intended to provide a *federal* damage remedy for every conceivable dereliction.[29] Such persons still have their State court remedies, as the Trustee, SIPC and the Weis customers well understand in maintaining their State court

[29] *Cf. Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970) ("That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. The remedy in many cases may be found in the state courts. . . . If there is to be a federal remedy, it is the Congress which must create it"), *cited with approval in Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 738-739 n.9. *See also* 78 CONG. REC. 2270 (1934) (remarks of Senator Fletcher, sponsor of Senate bill S.2693, which eventually became the 1934 Act).

actions on the basis of allegations identical to those asserted here (*see* pp. 6-7, 16 n.12, *supra*),[30] and it would impermissibly conflict with the clear statutory scheme to disregard the requirements of Section 18(a) in order to permit them also to sue in the federal courts.

Thus, the real issue here is not whether to grant the customers a Section 17(a) implied remedy or else to leave them without any protection, but rather whether to add to the protections they already have the additional protection of a Section 17(a) implied remedy that Congress itself intentionally refused to provide.

Moreover, the conclusion of the Court of Appeals majority that Section 18(a) is irrelevant simply does not follow from its premises that Section 17(a) protects brokerage firm customers and that Section 18(a), because it protects purchasers and sellers only, would not normally be available to them. Even if those premises were assumed to be correct, and even if it be assumed that the Court of Appeals were correct in also postulating that "protection of [brokers' customers] is wholly independent" from Section 18(a) (A.201), the existence of Section 18(a) nevertheless necessarily demonstrates a Congressional intention that the purchasers and sellers referred to therein be the only class with a damage remedy for misstatements in Section 17(a) reports. If, in enacting the 1934 Act, Congress was as aware of, and consciously concerned with protecting, both brokerage firm customers (its "favored wards" in Section 17(a), according to the majority) and purchasers and sellers (to whom it pro-

[30] *Cf. Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 738-739 n.9 (observing that any disadvantages of the purchaser-seller rule are "attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law", that redress for the conduct alleged in the *Birnbaum* case ultimately was obtained "in a cause of action based on state law", and that plaintiffs in *Blue Chip Stamps* had commenced a parallel state court action).

vided the express damage remedy in Section 18(a)), the withholding of an express damage remedy from the customers, while at the same time giving such a remedy to the purchasers and sellers, can only mean that Congress consciously intended that the customers not have a damage remedy and that their protection be provided in a different way. As Judge Mulligan's dissent correctly puts it,

> "if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers" (A. 212).[31]

D. The Necessity Standard Of *Piper* Bars Implication Of A Private Right of Action Under Section 17(a).

In *Piper* v. *Chris-Craft Industries, Inc., supra,* this Court held that private rights of action for damages under the 1934 Act are not to be implied unless "*necessary* to effectuate Congress' goals", and pointed out that such a "necessity" standard goes as far back as its 1964 decision in *J. I. Case Co.* v. *Borak* (where it was "necessary" to

[31] Significantly, Section 18 is entitled "Liability for Misleading Statements" (instead of, for example, "Rights of Purchasers-Sellers"), thereby plainly demonstrating that the Congressional intention in Section 18(a) was not simply to grant a remedy to purchasers and sellers, but to delineate the full scope of liability for misleading statements in filed reports by providing that purchasers and sellers were the only class to which a remedy for such statements was to be available. *Cf. Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 734 ("When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly").

imply such a right of action under Section 14(a) of the 1934 Act in order to achieve its purposes) (emphasis added). 430 U.S. at 25-26.[32] *Accord, Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 477; *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 62-63 (1975). The District Court here properly recognized that no private right of action could be implied under Section 17(a) unless it met the "necessity" test of *Piper,* and carefully pointed out that "[t]his test has . . . been applied here and no such implication found 'necessary'" (A.182-A.183). Similarly, Judge Mulligan in dissent, after extensive discussion of the pertinent factors (A.216-A.222), correctly concluded that "there is no showing here that a private damage remedy [under Section 17(a)] against accountants is *necessary* to vindicate the primary congressional purpose embodied in section 17(a)" (A.222). On the other hand, as Judge Mulligan pointed out, the Court of Appeals majority "fail[ed] to consider the impact" of *Piper* and its necessity standard (A.216).

1. Implication Of A Private Right Of Action Under Section 17(a) Is Not "Necessary".—Proper analysis demonstrates that, as Judge Mulligan and the District Court found, implication of a private right of action is not "necessary" to effectuate the Congressional purposes underlying Section 17(a). It is to be emphasized that, in making the analysis, and as made clear in *Piper,* it is improper to imply a private damage remedy where the

[32] As Judge Mulligan noted in his dissent, "[t]he underscoring of the element of necessity three times in the *Piper* opinion, 430 U.S. at 25, indicates the emphasis the Court wished to bring to this factor in determining whether a private remedy should be implied" (A.216 n.6). Judge Mulligan also pointed out that, since *Piper* involved Section 14(e) of the 1934 Act, for which no express remedy whatsoever was provided, and therefore presented a *Cort* v. *Ash* situation, the Court's emphasis on the necessity factor means that "*Piper* . . . is not simply a restatement or affirmation of *Cort* but adds a significant gloss" (A.216 and n.6, A.222).

only reason is that such a remedy would accord, or be consistent, with a general statutory purpose, and that such a remedy can be regarded as "necessary" only "where *congressional purposes are likely to be undermined* absent private enforcement" (emphasis added). 430 U.S. at 25. *See also Lank* v. *New York Stock Exchange,* 548 F.2d 61, 65 (2d Cir. 1977) ("[e]ven were we to agree with [plaintiff] that granting him a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place").[33]

Moreover, it is also important that the creation of a damage remedy is not made "necessary" simply because it would impose an added damage penalty on the alleged wrongdoer. As *Piper* makes explicit, an "ever-present threat of damages" is not in and of itself *necessary,* because "[t]he deterrent value, if any" of a private right of action is so speculative that it does not "provide significant additional protection". 430 U.S. at 39-40. *Cf. Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.,* 417 U.S. 703, 717 (1974) (deterrence of wrongful conduct is not in itself a sufficient ground to permit any plaintiff to recover); *Fridrich* v. *Bradford,* 542 F.2d 307, 321 (6th Cir. 1976), *cert. denied,* 429 U.S. 1053 (1977).

The Congressional purpose in providing for the scheme by which brokerage firms are regulated and of which Section 17(a) is an integral part was to provide a reporting and monitoring system which would help prevent brokerage firm insolvencies. Thus, the preventive monitoring of brokerage firms by the SEC, the Exchange and SIPC under the regulatory scheme—a scheme which

[33] The Court of Appeals majority therefore does not advance its argument by asserting that "a private right of action under Section 17 is *consistent* with [the legislative] purposes" (emphasis added) (A.199).

includes as an important element the net capital rule and the requirement that Section 17(a) reports contain data necessary to determine compliance with that rule[34]—is extensive.[35] The SEC has available to it investigative, criminal and injunctive proceedings to enforce compliance with, and to deter violations of, the regulatory requirements. *See, e.g.,* 15 U.S.C. §78u; *United States* v. *Sloan,* 389 F.Supp. 526 (S.D.N.Y. 1975); *Securities & Exchange Commission* v. *Resch-Cassin & Co., Inc.,* 362 F.Supp. 964, 979 (S.D.N.Y. 1973).[36] Since 1970, when SIPA was enacted, the regulatory scheme has included SIPC, with not only the function of participating in the preventive monitoring of the brokerage firms and seeking liquidation of such a firm where necessary, but also with the function of ensuring that brokerage firm customers are protected

[34] The Court of Appeals majority pointed out that "[o]ne of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325", and that "[i]t is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule" (A. 197-A. 198). The majority also pointed out that "[t]he net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its 'principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers.' Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶72,129 (1967)" (A.197; *see also* A. 217 (dissent)).

[35] For example, the SEC itself, in its brief *amicus curiae* (at 25-26 n.37) submitted to the Court of Appeals, conceded that its "broker-dealer inspection program is an extensive one". The SEC examines "[e]ach of the approximately 750 broker-dealers who are not members of self-regulatory organizations . . . every year for compliance with Commission regulations", as well as "roughly 5 percent" of those belonging to self-regulatory organizations and "about 500" each year "for 'cause' (usually as a result of a complaint received)". Under certain circumstances, "much closer scrutiny is provided by the Commission". *Id.*

[36] As already noted herein (pp. 5-6, *supra*), and as pointed out by Judge Mulligan (A.219 n.8), injunctive and criminal sanctions were obtained in the Weis situation against Weis and the Weis Five.

against loss by providing funds to pay customer losses.[37] And, of course, there are available to such customers the usual state law remedies, including common law actions for damages against accountants. *See, e.g., White* v. *Guarente,* 43 N.Y.2d 356, 372 N.E.2d 315 (1977); RESTATEMENT (SECOND) OF TORTS §552 (1977).

In view of the foregoing, Judge Mulligan was clearly correct in concluding that "the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers[,] not to create private law suits for damages *after* insolvency has occurred" (A.219).[38] Judge Mulligan also

[37] The enactment of SIPA, and its creation of SIPC to provide funds to pay customer losses, reflects a Congressional understanding that no federally-created remedy (*e.g.,* an implied private right of action for damages under Section 17(a)) was available to compensate against such losses, and that—to the extent that it considered existing remedies for customers to be inadequate—it was enacting SIPA and creating SIPC to fill that void by providing whatever additional protection for customers it believed necessary. *Cf. International Brotherhood of Teamsters* v. *Daniel, supra,* 47 U.S.L.W. at 4139 ("The existence of this comprehensive legislation [ERISA] governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. *Congress believed that it was filling a regulatory void* when it enacted ERISA" (emphasis added)). *See also* p. 47 n.24, *supra* (1975 amendments to the 1934 Act). Significantly, the maximum amount that SIPC is required to advance for each customer was recently increased from $50,000 (of which not more than $20,000 could have been in respect of a claim for cash), *see* 15 U.S.C. § 78fff(f)(1) (1970), to $100,000 (of which not more than $40,000 may be in respect of a claim for cash), *see* 15 U.S.C.A. § 78fff-3(a) (Supp. V 1978). Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 9, 92 Stat. 260, 265 (1978).

[38] Judge Mulligan reached his conclusion because "the plain language of Section 17 establishes *the congressional concern that the SEC be kept on notice* of the financial health and stability of registered broker-dealers through whom public investors purchase and sell securities" (A.216); because "[t]he SEC itself has long recognized that the *primary protection for brokers' customers lies in preventive monitoring*" under a regulatory system which includes the "net capital rule" and which ensures "[c]ompliance by broker-dealers with the net capital rule . . . by *the filing of reports* [*by the broker-dealers*] *and monitoring by SEC as well as by the Exchange*" (A.217); and because of the enactment in 1970 of SIPA and the creation therein of SIPC,

correctly found that the "importance to this scheme of implying a damage remedy [under Section 17(a)] *after* liquidation [of a brokerage firm] is dubious", and that in any event the implication of such a remedy is not *necessary* to effectuate the Congressional goals (A.219-A.221). In the 45 years since enactment of the 1934 Act the regulatory scheme has operated without a single court other than the Court of Appeals majority here finding it appropriate—let alone "necessary"—to imply a private right of action for damages under Section 17(a). Moreover, as the District Court noted, "criminal prosecutions and SEC injunctions seem abundantly sufficient" to enforce, and to deter other violations of, the reporting requirements of Section 17(a) (A.182). As Judge Mulligan noted, "[t]he threat of liquidation under SIPA as well as the criminal sanctions available for violations of Section 17(a) certainly present a greater deterrent than private damage actions"; furthermore, ample "available state law remedies" arising from "well established tort law principles" also exist to deter misconduct by accountants (A.219-A.221). *Cf. Fridrich* v. *Bradford, supra,* 542 F.2d at 321-322.

In considering the necessity factor, it is also important not to confuse Section 17(a) with the prospectus provisions, the antifraud provisions and the proxy provisions. Those other provisions have a different basic purpose—*i.e.,* to insure that investors have available to them such data as Congress thought they would require in order adequately to proceed with their own investment and corporate voting activities—and the filing of such data with the SEC and other regulatory authorities is only incidental to its transmission to the investors, so that the SEC and other regulatory authorities can exercise "only an oversight or policing function" with respect thereto (A.181 (District Court)). Where that basic purpose exists, and

not only to "provid[e] protection to investors upon the liquidation of their brokers", but also to "*maintain . . . an early warning system* and *monitor . . . the affairs* of any [brokerage] firm that it is given reason to believe may be in danger of failure" (A.217-A.218) (emphasi added).

where investors are the primary recipients of data that is to influence their conduct in purchasing and selling securities or in corporate voting, and the SEC and the regulatory authorities have only an oversight role, private damage actions by such investors may be a necessary supplement to SEC action. However, as shown hereinabove and as recognized by Judge Mulligan and the District Court, the basic purpose of Section 17(a) is drastically different. The SEC and other regulatory agencies are the primary recipients of the information required thereby, and the basic purpose of the reports is to permit the SEC and other regulatory authorities to monitor brokerage firms, not to provide to investors data for their investment decisions. Investors are affected not as a direct result of their own decisions in reliance on the pertinent data, but only consequentially by the overall success or failure of the regulatory authorities in achieving their objectives.[39] In that context, it is *unnecessary* to imply a private damage remedy under Section 17(a) in order to effectuate the Congressional purposes of, and the failure to imply such a remedy will not "undermine", the regulatory scheme.

2. THE COURT OF APPEALS MAJORITY ERRED IN CONCLUDING THAT AN IMPLIED RIGHT OF ACTION IS "NECESSARY". — None of the reasons advanced by the Court of Appeals majority to support implication of a private right of action under Section 17(a) satisfies the *necessity* requirement of *Piper.* For example, the majority's conclusion, purportedly premised upon *J. I. Case Co.* v. *Borak, supra,* that "a private remedy is an essential supplement to the scheme of enforcement of section 17" because the SEC "does not have the resources to examine

[39] Of course, information supplied to the regulatory authorities in Section 17(a) reports may well find its way into the hands of investors and be used by them in making investment decisions, *i.e.*, decisions to purchase or sell securities. In such situations, Section 18(a) provides an express remedy to the investors for damages caused by their reliance upon misstatements in the Section 17(a) reports.

and audit all the documents that it receives" (A.199, A.200) simply is unacceptable. While the majority appears to have belittled the activities of the SEC in examining financial reports of brokerage firms (A.199 n.12), the SEC itself admits that its monitoring activities are extensive (*see* p. 61 n.35, *supra*), and Congress regards those activities as an important part of the regulatory scheme of which Section 17(a) is a part. *See* S. REP. NO. 94-75, 94th Cong., 1st Sess. 120, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 297 ("Examination authority, contained in present Section 17(a) is, of course, essential to any effort by the Commission to discharge its responsibilities under the Act"). Moreover, even if it be assumed that there are practical limitations on the SEC's ability to perform examinations,[40] such limitations themselves are insufficient to require implication of a private right of action under Section 17(a), particularly in light of this Court's admonition in *Piper* that "[e]ven though the SEC operates in this context under the same practical restraints recognized by the Court in *Borak,* institutional limitations alone do not lead to the conclusion that any party interested . . . should have a cause of action for damages". 430 U.S. at 41. As Judge Mulligan's dissent points out, "[t]he argument that a regulatory agency is confessedly unable properly to regulate broker-dealers as charged by Congress and detailed by its own regulations, and that therefore the federal courts should find a damage remedy implicit in an act which studiously avoided giving one to the class sought to be represented here, is simply unpersuasive" (A.221).

Similarly unacceptable is the majority's reliance upon an asserted need for nationally uniform standards for

[40] In fact, as Judge Mulligan's dissent pointed out, the problem referred to in *J. I. Case Co.* v. *Borak, supra,* with respect to the SEC's ability to examine proxy statements under demanding time limitations, is not encountered with respect to its examination of Section 17(a) reports, and the SEC's burden also is lightened by examinations that are performed by the Exchange of net capital statements of its members (A.221 n.11, *see also* A.181-A.182 (District Court)).

actions brought to recover losses after a brokerage firm has failed (A.200). Since the *primary* legislative purpose in enacting Section 17(a) was to provide a system of reports and monitoring to *prevent* insolvency, providing uniform standards for recovery of losses resulting from liquidation would not, and is not *necessary* in order to, achieve that purpose, even if it be assumed that the majority was correct in asserting that "state law protection of brokers' customers varies widely" (*id*; *but see* A.219-A.220 (dissent)). This Court recently has restated the principle that where state law remedies traditionally have been available federal courts should be reluctant to intrude federal remedies into the area to serve " 'at best a subsidiary purpose' of the federal legislation", *Sante Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 478, and has recognized that relegation of plaintiffs to such state law remedies is appropriate, *e.g., id.* at 478 (state law appraisal remedy); *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 40-41 (common law tort remedy).

Finally, in light of the foregoing, the observation by the Court of Appeals majority that "[n]either SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost" (A. 199) is not relevant. The purpose of Section 17(a) is not compensatory, and the absence of a federal damage scheme for violations thus will not frustrate or undermine the statutory purpose.

E. Even If *Cort* v. *Ash* Did Provide The Applicable Analysis Here, It Does Not Permit Implication Of A Private Right of Action Under Section 17(a).

As already shown, the Court of Appeals majority erred in relying upon a *Cort* v. *Ash* analysis in light of its express limitation to "determining whether a private remedy is implicit in a statute not expressly providing one" (pp. 39-40, 54-55, *supra*), and because the majority did not properly take into account the "necessity" factor which *Piper* requires as a part of any such analysis (pp. 58-66, *supra*). However, even if the factors specifically identified in *Cort* v. *Ash* were assumed to be the only appropriate ones for consideration, they too require the conclusion that Section 17(a) creates no implied private right of action and that the Court of Appeals majority erred in holding to the contrary.

First, the existence of Section 18(a) shows that insofar as private rights of action for damages may be derived from reporting obligations imposed by the 1934 Act, only purchasers and sellers, and not customers, are *the class for whose special benefit such rights and remedies are provided,* even though the statute through its preventive monitoring scheme, as opposed to its scheme of private civil remedies, more generally also seeks to provide protection for brokerage firm customers. Second, the statutory scheme reflects *a legislative intent* to deny a remedy here. Section 18(a) provides an express private right of action for damages to purchasers and sellers of securities who rely in their securities transactions upon misleading reports filed under Section 17(a). That fact, combined with legislative history which shows no express intention to create a damage remedy for anyone other than purchasers and sellers, evidences a Congressional intention to restrict causes of action to those who satisfy the requirements of Section 18(a). Third, an implied right would *not be consistent with the legislative scheme,* since it would effectively abolish the purchaser-seller limitation that Congress placed on express damage remedies.

Finally, the rights of action that the Trustee and SIPC allege normally are asserted in common law actions for accountants' negligence and malpractice. The purchaser-seller requirement of Section 18(a) shows a Congressional understanding that any cause of action by customers for damages is *one traditionally relegated to State law* which, under "well established tort law principles" (*see* pp. 56-57

and n.30, 63, *supra*), provides appropriate remedies—remedies which are being pursued as against Touche Ross by the Trustee and SIPC in the State Court Action, and by Weis' customers themselves, and to which they all appropriately should be relegated (*see* pp. 6-7, 16 n.12 *supra*).

F. *Borak* Does Not Require Implication Of A Private Right Of Action Under Section 17(a).

The Court of Appeals majority erroneously relied upon *J. I. Case Co.* v. *Borak, supra,* and its "statutory tort" theory (A.199; *see also* A.206 (concurrence)), both of which have been, as Judge Mulligan's dissent notes, "significantly restricted by more recent decisions" of this Court (A.209-A.210 and n.2). As the District Court also recognized, not only is "the case at bar. . . not like *Borak*", but the "Supreme Court has refused to expand the *Borak* principle" and "indeed . . . . has restricted it" (A.180-A.182). Other decisions also have recognized that *Borak* is not authority for implying a private right of action for damages from the reporting provisions of the 1934 Act. *E.g., In re Penn Central Securities Litigation, supra,* 347 F.Supp. at 1339-1340.[41]

[41] Even accepting that *Borak* was, within the pertinent statutory context and taking into account the stage of development of remedies under the federal securities laws in 1964, properly decided, its language is so broad that it does not now provide a sufficiently discriminating analytical framework to determine whether remedies properly may be implied under the federal securities laws, which have seen 25 years of further development. While this Court's subsequent decisions preclude any unduly broad reading of *Borak* (*see, e.g.,* A.209-A.210 and n.2 (dissent); A.182 (District Court)), the reliance by the Court of Appeals majority (A.199; A.206 (concurrence)) on *Borak's* broad language, and the majority's refusal to acknowledge the restrictions imposed by subsequent decisions, demonstrate the confusion and ambiguity still generated for some lower federal courts by *Borak*. It would eliminate that confusion and ambiguity, and would provide clearer guidelines in an area where the lack of clarity seriously burdens the federal judiciary, if this Court would unequivocally state that—as is the import of its current decisions—*Borak* does not now set forth the appropriate analysis for determining the existence of implied remedies.

Section 14(a) of the 1934 Act—the statutory provision involved in *Borak*—is designed to protect a stockholder's voting rights, and (through Rule 14a-9) makes "unlawful" any false or misleading proxy statement. This Court in *Borak* found it "necessary" to imply a private right of action to protect Section 14(a) rights for various reasons which make *Borak* distinguishable from this case. In the first place, there was no express remedy provided in the 1934 Act for violations of Section 14(a), an aspect emphasized by *Piper* ("the relevant provisions are silent as to remedies"—430 U.S. at 25). Moreover, Section 14(a), far from simply imposing reporting requirements, "stemmed from the congressional belief that '*[f]air corporate sufferage is an important right* that should attach to every equity security bought on a public exchange'" (emphasis added). 377 U.S. at 431; *see also Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25.

Borak is also inapplicable here, since the Section 17(a) reports in issue were not intended to provide information to investors to aid them in their decisions or to influence them to act with respect to a particular transaction or matter. The District Court correctly recognized this, in pointing out that

> "the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any 'investors' and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act" (A.182).

Consequently, as the District Court emphasized, whereas this Court has "referred to *Borak* as an instance where there was 'a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard'", here there is "no such

'pervasive legislative scheme'" (A.182). Indeed, the "legislative scheme" of which Section 17(a) is a part includes Section 18(a) and its express remedy for the class to which Congress intended to give a remedy, and compels the conclusion (contrary to that reached in *Borak*) that Congress intended no other remedy to be available.

The Court of Appeals majority also erred by unduly emphasizing the "protection of investors" language of Section 17(a) that is similar to the language involved in *Borak* (A.196). That a particular statutory provision is intended for the "protection of investors" does not necessarily mean that a private right of action is to be implied thereunder. For example, in *Amtrak, supra,* this Court rejected the contention, based upon *Borak,* that a right of action under the Amtrak Act should be implied in favor of an association of railroad passengers simply because "railroad passengers are the intended beneficiaries of the Act". 414 U.S. at 457. *See also, e.g., Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 421 ("Congress' primary purpose . . . was, of course, the protection of investors. It does not follow, however, that an implied right of action by investors who deem themselves to be in need of [SIPA's] protection is either necessary to or indeed capable of furthering that purpose"); *In re Equity Funding Corp. of America Securities Litigation, supra,* 416 F.Supp. at 190.

Moreover, as the District Court recognized, an indispensable element of the decision in *Borak* was that an implied private remedy under Section 14(a) was a "necessary supplement to [SEC] action" because the SEC "had not the time for an 'independent examination'" of proxy material (A.181). *See also Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25. Here, that problem is not encountered by the SEC with respect to its examination of Section 17(a) reports (see pp. 64-65 and n.40, *supra*).

G. Serious Policy Considerations Militate Against The Implication Of A Private Right Of Action Under Section 17(a).

In *Blue Chip Stamps* v. *Manor Drug Stores, supra,* this Court noted that to the extent that it was unable "to divine from the language of [Section] 10(b) [of the 1934 Act] the express 'intent of Congress'", it was proper to "consider, in addition to the factors [of statutory construction] already discussed, what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance". 421 U.S. at 737. However, in *Ernst & Ernst* v. *Hochfelder, supra,* the Court subsequently stated that it found "the language and history of §10(b) dispositive" of the question there involved and thus "there is no occasion to examine the additional considerations of 'policy,'. . . that may have influenced the lawmakers in their formulation of the statute", although it did note the serious policy difficulties that would be raised by the expanded scope of liability unsuccessfully urged by plaintiffs. 425 U.S. at 214 n.33. While the language, context and history of Sections 17(a) and 18(a) are dispositive here and require a holding that no private right of action may be implied under Section 17(a), the pertinent policy considerations, to the extent that it is appropriate to consider them, also require that holding.

1. Expansion Of The Scope Of Liability Under The 1934 Act Raises Serious Issues That More Appropriately Should Be Addressed By Congress.—This Court has observed that serious problems arise when a remedy which "would significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or express opinions with respect to matters under the [federal secu-

rities] Acts" is judicially implied, and has emphasized that "we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good". *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 214-215 n.33; *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 747-748. In this connection, both *Hochfelder* and *Blue Chip Stamps* cited *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179-180, 174 N.E. 441, 444 (1931), and quoted with approval therefrom Chief Judge Cardozo's observation, "with respect to 'a liability in an indeterminate amount for an indeterminate time to an indeterminate class' ", that

> "[t]he hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences".

While in *Hochfelder* and *Blue Chip Stamps* the statutory language and history offered the guidance as to the Congressional intent that this Court found to be necessary for determining the scope of liability under Section 10(b), the language and history of Section 17(a) offer no similar guidance (except the guidance provided by Section 18(a)) as to the Congressional intent concerning the scope of liability thereunder, and there is the danger that such liability (and its substantial consequences to the accounting profession) may remain "indeterminate". Determination of its scope thus would be an inappropriate judicial task, because it necessarily would depend upon an analysis of factors which are legislative in nature and which require (but, except to the extent that they are reflected in Section 18(a),[42] have not

[42] As the legislative history and ultimate text of Section 18(a) demonstrate, Congress concluded after hearings that, even with the purchaser-seller limitation, the liability that would have been created by the originally proposed versions thereof was too broad, and

yet received) Congressional consideration in the first instance. Moreover, it would be a difficult judicial task—as is demonstrated by the fact that the Court of Appeals majority expressly declined to articulate "what the appropriate standard is for accountant liability in actions under section 17"(A.204).

Because neither Section 17(a) nor its legislative history provides any standards that would provide a sound basis for proper judicial articulation of the scope of any implied private right of action against accountants for violation of Section 17(a), the holding of the Court of Appeals majority necessarily is open-ended and has the potential for effecting an extreme expansion of the scope of civil liability under the 1934 Act. That holding is not necessarily limited to providing a federal right of action in all cases where state law would provide to customers a remedy for accountants' negligence and malpractice in auditing and certifying financial statements such as those contained in Section 17(a) reports. In this case, while the Trustee and SIPC do seek simply to "federalize" their common law claims, liability for damages resulting from the failure of the SEC, SIPC, and the self-regulatory organizations to adequately monitor and supervise the activities of a securities brokerage firm also is sought to be imposed, for the first time and without any express evidence of legislative intent to impose such liability, upon accountants whose alleged negligence and malpractice resulted in their failure to discover that their client wilfully withheld from those organizations information that *might* have enabled them more adequately to perform their required regulatory duties. The accountants would vir-

therefore limited actions thereunder by imposing a *scienter* requirement and a short statute of limitations, and by granting authority to require a plaintiff to post a bond for costs. *See Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 211-212 n.31. *See also* brief *amicus curiae* (at 9-11) of the American Institute of Certified Public Accountants.

tually be made insurers of the success of the entire regulatory scheme, including its so-called "early warning system." By accepting an engagement to render their professional opinion with respect to a brokerage firm's Section 17(a) reports, accountants would be held to have accepted thereby delegation to them of, and responsibility for, virtually all of the regulatory organizations' monitoring duties. If the regulatory system failed to achieve its objectives, as it did in the Weis situation, the regulatory authorities, whose statutory responsibility it is to protect customers, all would profess ignorance and innocence. The accountants—convenient scapegoats whom the statute does not even mention (*see also* pp. 79-80, *infra*)—would be held to blame. The risks of brokerage firm insolvency would be shifted from SIPC (upon which Congress expressly imposed those risks) to the accountants (*see also* pp. 105-106, *infra*), and they would be required to compensate the customers for the regulatory failure. Moveover, these consequences would be imposed upon the accounting profession without the slightest evidence that Congress ever considered the wisdom thereof.

Consequently, the creation of an implied private right of action under Section 17(a) here makes pertinent if not compelling the observation in *Ernst & Ernst* v. *Hochfelder* that "[a]cceptance of respondents' view would extend to new frontiers the 'hazards' of rendering expert advice under the Acts, raising serious policy questions not yet addressed by Congress". 425 U.S. at 216 n. 33.

2. IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17(a) WOULD NEEDLESSLY BURDEN THE FEDERAL COURTS WITH LITIGATION THAT SHOULD MORE APPROPRIATELY BE RELEGATED TO THE STATE COURTS.—The recognition of a new implied right of action under Section 17(a)—a right of action not heretofore perceived by any other court or litigant in the 45

years since enactment of the 1934 Act—has the serious potential for adding to the already large volume of litigation under the 1934 Act in the federal courts, and thereby further burdening them with, an additional large volume of litigation which involves essentially claims of accountants' negligence and malpractice, and which traditionally has been, and more appropriately should be, adjudicated in the State courts. If such a right of action is implied, all customers of failed or failing brokerage firms will have a potential Section 17(a) right of action against third parties allegedly responsible for misstatements in Section 17(a) reports. The resulting likelihood of proliferating litigation is seen from the facts that (i) between 1970 and 1977, 128 brokerage firms have failed and been placed in SIPA liquidation, (ii) such failures, seven of which occurred in the last year for which data is available (1977), continue to be a fact of life in today's mercurial and often troubled securities markets, and (iii) the total number of customers of such failed brokerage firms is huge, with more than 104,000 customer claims already having been satisfied in whole or in part in SIPA liquidations as of December 31, 1977.[43] That the prospect for a greatly-expanded volume of 1934 Act litigation is real, and not simply speculative, is demonstrated by the commencement in the District Court only six days after the decision of the Court of Appeals here of a customers' class action against Touche Ross asserting implied rights of action under, and seeking damages for alleged violations of, Section 17(a) *(see* p. 16 n.12, *supra)*.

Moreover, the satisfaction of customer claims in brokerage firm liquidations does not remove—indeed, appears even to increase—the potential for 1934 Act litigation, in light of the holding by the Court of Appeals majority that SIPC, to the extent that it advances funds for

[43] SIPC SEVENTH ANNUAL REPORT (1977) 5-6, 28.

payment of such claims, is subrogated to and may assert customers' Section 17(a) rights against third parties. As of December 31, 1977, SIPC had advanced almost $54,000,000 for payment of customers' claims (*i.e.*, almost $40,000,000 in excess of the $14,000,000 advanced for payment of such claims in the Weis liquidation)[44]—advances so substantial as to demonstrate a likelihood that SIPC will find itself compelled to assert such Section 17(a) claims. Of course, the potential for greatly-increased 1934 Act litigation is not limited to situations where the brokerage firm involved is in liquidation, because Section 17(a) claims could be asserted by customers with respect to the Section 17(a) reports of any of the over 5,000 brokers and dealers registered with the SEC.

Furthermore, the class of plaintiffs who may seek to invoke an implied remedy under Section 17(a) is not limited to SIPC and the presumably small number of customers whose claims for the net equity in their accounts exceed the maximum amounts of protection provided under SIPA (*see* p. 62 n.37, *supra*). Even customers whose claims do not exceed the SIPA limits, and therefore may be "fully" satisfied in accordance with the formulae set forth in SIPA, may argue that they have incurred damages the recovery of which they may seek under Section 17(a). *See Rich* v. *New York Stock Exchange,* 522 F.2d 153 (2d Cir. 1975) (holding that brokerage firm customers who ostensibly have been compensated "fully" under SIPA nevertheless may be able to prove and recover damages that arise from a brokerage firm liquidation but for which no compensation is provided under SIPA). Significantly, the Weis customers who already have sued Touche Ross as a result of the decision of the Court of Appeals majority here seek, *inter alia,* recovery

[44] SIPC SEVENTH ANNUAL REPORT (1977) 6, 28-29.

of precisely the damages referred to in *Rich* v. *New York Stock Exchange.* Since *any* customer of a defunct brokerage firm can claim to have suffered such damages, the class of plaintiffs who may seek to invoke an implied Section 17(a) remedy is huge.[45]

It is significant that the burden that would be placed upon the federal courts by the creation of a Section 17(a) implied private right of action would be an ***unnecessary*** burden. The claims asserted here, and the similar claims which might be asserted by any brokerage firm customer for misstatements in Section 17(a) reports, are essentially common law claims for accountants' negligence and malpractice, which traditionally have been a concern of State law and for which State law provides appropriate remedies (*see* pp. 56-57, 67-68, *supra*). Of course, this is evidenced here by the fact that not only do the Trustee and SIPC have pending the State Court Action, but customers of Weis also have pending New York State court actions against Touche Ross for damages allegedly resulting from Touche Ross' certification of the Weis financial reports (*see* pp. 6-7, 16 n.12, *supra*).

3. ABANDONMENT OF THE PURCHASER-SELLER REQUIREMENT OF SECTION 18(a) WOULD INCREASE THE DANGER OF VEXATIOUS LITIGATION.—As already noted (pp. 48-51, *supra*), the creation of an implied private right of action under Section 17(a), by eliminating the purchaser-seller requirement of Section 18(a), would defeat the salutary purposes of that requirement that were recognized by this Court in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 737-749, and that led it to uphold such a requirement as necessary to avoid the

[45] For reasons stated hereinafter (pp. 103-104, *infra*), if any right of action is implied on behalf of customers for violation of Section 17(a), it should not be available to recover losses for which SIPC is required to compensate the customers. In that event, damages for which SIPC compensation is unavailable would be the only damages for which recovery could be sought under Section 17(a).

"danger of vexatious litigation which could result from a widely expanded class of plaintiffs". 421 U.S. at 740, 743-749. *See also Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 478-479.

4. IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17(a) WOULD GIVE IMPETUS TO EFFORTS TO IMPLY SIMILAR RIGHTS UNDER THE OTHER REPORTING PROVISIONS.—Since Section 17(a) is a reporting provision, a holding that a private right of action may be implied thereunder would be authority for implying rights of action under all of the other reporting provisions of the 1934 Act in favor of persons who are not purchasers or sellers and who therefore may not assert the express remedy provided in Section 18(a). Numerous plaintiffs already have sought to assert such implied rights in the actions already cited herein (pp. 51-54, *supra*) and, although the efforts of such plaintiffs heretofore have been unsuccessful, affirmance of the Court of Appeals majority's holding here only would give new impetus to such efforts.

II

Under Any Circumstances, Section 17(a) Does Not Create Any Implied Private Right Of Action For Damages Against Accountants, Upon Whom It Imposes No Duties, Or In The Absence Of *Scienter*

Even if it be assumed that Section 17(a) creates an implied private right of action on behalf of brokerage firm customers against their brokerage firm for damages from misstatements in its Section 17(a) reports, no such right of action may be implied (a) against accountants, because Section 17(a) does not impose any duty upon them, or (b) in the absence of *scienter,* because any implied right of action based on negligence would be *broader* than the express remedy of Section 18(a), and would be inconsistent with the holding with respect to implied remedies in *Ernst & Ernst* v. *Hochfelder, supra.*

A. Section 17(a) Imposes No Duty Upon Accountants Such As Touche Ross.

Notwithstanding whether brokerage firm customers have a Section 17(a) implied private right of action as against *their brokerage firm* for damages from misstatements in its Section 17(a) reports, no such right of action may be implied against *accountants* such as Touche Ross. The language of Section 17(a) does not refer to, and does not impose any duty upon, accountants who have allegedly audited and certified financial reports filed pursuant thereto. As the District Court held,

> "Section 17 does not impose any duty on accountants. It specifically mentions a 'national securities exchange', the members thereof, a 'registered securities association', brokers, and dealers; it does not mention accountants. While the regulations do contain provisions respecting an accountant's certificate . . . the oath is only by the broker or dealer" (A.183).

Cf. Rothstein v. *Seidman & Seidman,* 410 F.Supp. 244, 248 (S.D.N.Y. 1976) (special instruction accompanying stock exchange audit rule "is directed to Exchange members . . . [and] makes no reference to nor imposes any duty upon an auditing accountant from which a private right to damages could be implied"); *In re Equity Funding Corp. of America Securities Litigation, supra,* 416 F.Supp. at 190 (Section 13(a) and rule thereunder "impose duties only on issuers and not accountants").

The Court of Appeals majority relied upon "the regulations [in Rule 17a-5] promulgated by the SEC" pursuant to Section 17(a), and the purported recognition

therein that "accountants play a significant role in the [regulatory] scheme", to support its holding that Section 17(a) "imposes a duty on accountants" (A.195). However, as the District Court recognized, while Rule 17a-5 does refer to accountants, it does not by its terms impose any duty on them. Moreover, an interpretation of Rule 17a-5 that would derive therefrom a duty on accountants that is not imposed by Section 17(a) itself would be impermissible, because it is well-established that "the language of the statute must control the interpretation of the Rule". *Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 472; *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 214 ("[the] scope [of the rule] cannot exceed the power granted the Commission by Congress"). Further, any ambiguity as to whether Rule 17a-5 does in fact impose a duty upon accountants should preclude a private right of action against them from being implied thereunder. *Cf. Drasner* v. *Thomson McKinnon Securities, Inc.,* [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,080 at 91,887-91,888 (S.D.N.Y. 1977).

B. Section 17(a) Does Not Create Any Implied Private Right Of Action In The Absence Of *Scienter.*

Even if it be assumed that a private right of action may exist under Section 17(a), it is clear that *scienter* must be a necessary element thereof. *Ernst & Ernst* v. *Hochfelder, supra.* In holding that *scienter* was an essential element in a private action for damages under Section 10(b) and Rule 10b-5, *Hochfelder* observed that the "1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities", and that

> "it [is] significant that each of the express civil remedies in the 1933 Act allowing recovery for negligent conduct . . . is subject to *significant procedural restrictions* not applicable under §10(b) . . . . We think *these procedural limitations* indicate that the judicially created private damages remedy under §10(b)—which has no comparable restrictions—cannot be extended, consistently with the intent of Congress, to actions premised on negligent wrongdoing" (emphasis added). 425 U.S. at 206, 208-210 and n.30.

The "significant procedural restrictions" referred to include authorization for a district court to require plaintiffs to post a bond for costs (including attorneys' fees) and to assess costs at the conclusion of the litigation, and a short statute of limitations. The conclusion in *Hochfelder* that it would "nullify the effectiveness of the carefully drawn procedural restrictions on these express actions [for damages for negligent conduct]" to permit actions under Section 10(b) and Rule 10b-5 absent *scienter* applies equally as well to implied private actions (if any there be) under Section 17(a), because that section and the rules thereunder, like Section 10(b) and Rule 10b-5, obviously do not contain any of the "carefully drawn procedural restrictions" which Congress deemed necessary in the express provisions allowing recovery for negligent conduct.

Hochfelder also noted that there was no substantial support in the legislative history for permitting implied actions grounded on negligence, pointing to the fact that the original proposed version of Section 18(a) (which provides the express remedy for violations of reporting provisions such as Section 17(a)) would have imposed liability for negligence, and that Section 18(a) was changed in subsequent bill drafts so as to eliminate liability for negligence after "[t]he accounting profession objected to [the original] provision on the ground that

liability would be created for honest errors in judgment". 425 U.S. at 212 n.31.[46] The reasoning of *Hochfelder* thus requires that *scienter* be a necessary element of any implied private right of action under Section 17(a).

The complaint here alleges that Touche Ross performed its services in a "negligent, reckless, careless, unskilled and grossly negligent manner" (A.15 [¶28], *see also* A.23 [¶42], A.31 [¶84]), that Touche Ross failed to conduct its audit in accordance with generally accepted auditing standards and accounting principles (A.19 [¶31]), that Touche Ross' conduct was "negligence per se" (A.22 [¶37]) and "malpractice" (A.22 [¶39], A.28 [¶72], A.29 [¶76], A.30 [¶¶80, 82], A.31 [¶84]), that Touche Ross "knew or should have known" that Weis' financial statements were false (A.23 [¶41], *see also* A.26 [¶60], A.27 [¶65], A.30 [¶¶80, 82]), that Touche Ross failed to render services "in a thorough, proper, skillful and diligent manner" (A.23 [¶45]), and that Touche Ross *"would have discovered"* the fraud perpetrated by the officers of Weis if it had "audited, verified and examined" Weis' financial statements "in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC" (emphasis added) (A.16-A.17 [¶¶29(a), 29(b)]).

Those allegations do not set forth the necessary *scienter,* but simply charge negligence. They are virtually identical to the allegations in *Hochfelder,* which charged Ernst & Ernst with " 'failure' to conduct proper audits of First Securities" and were based on the premise that

[46] *Hochfelder* also noted that "[e]ach of the provisions of the 1934 Act that expressly create civil liability, except . . . 16(b) . . . contains a state-of-mind condition requiring something more than negligence". *Id.* at 209 n.28.

"Ernst & Ernst had failed to utilize 'appropriate auditing procedures' " and that "if Ernst & Ernst had conducted a proper audit, it would have discovered th[e] 'mail rule' " by which the broker-dealer's president implemented the fraudulent scheme. 425 U.S. at 190.

III

Even If (As The Court Of Appeals Majority Held) Section 17(a) Does Create An Implied Private Right Of Action In Brokerage Firm Customers Against Accountants, The Trustee May Not Assert Such Implied Right On Behalf Of Weis Customers Whose Property He Has Been Unable To Return

The Trustee has sought to recover two distinct kinds of damages allegedly resulting from Touche Ross' violation of Section 17(a). He has sought, first, to recover on behalf of Weis itself and in Weis' own right damages that Weis allegedly suffered, and, second, to recover damages suffered by customers of Weis whose property he was unable to return because of "depletion of the property held by Weis in trust for its customers" (A.9 [¶12], A.19-A.22 [¶¶31(d)-(i), 34, 35]).[47]

[47] The complaint does not allege the manner in which the property of the Weis customers was "depleted". However, the report filed by the Trustee in the Weis liquidation proceeding after dismissal of this action by the District Court and after argument in the Court of Appeals of the appeal therefrom—a report of which this Court may take judicial notice (*see* p. 16, n.12, *supra*)—gives the following explanation with respect to customer securities found to be "missing" at the commencement of the liquidation: "Most of the 'missing' securities were included in the collateral liquidated by banks to which Weis had pledged them to cover loans. The shortages were also caused by failures to receive securities due from other brokers and by temporary lags occurring in the normal course of business in the

The Court of Appeals majority and Judge Mulligan agreed, relying upon *Piper* v. *Chris-Craft Industries, Inc., supra,* and *Lank* v. *New York Stock Exchange, supra,* that the Trustee is not entitled to assert any claim on behalf of Weis itself under Section 17(a), because Weis was a member of the class regulated by, and not a beneficiary of, Section 17(a) (A.202-A.203, A.222-A.224 (dissent)). The Trustee has not sought review of that holding, the correctness of which is beyond dispute.

However, with respect to the Trustee's claims on behalf of the Weis customers, the Court of Appeals majority held, in purported reliance upon the common law doctrine of bailment and Rule 17(a), F.R. Civ. P., and over Judge Mulligan's dissent, that the Trustee "as bailee of the property of Weis' customers" is "an appropriate real party in interest to maintain this action on their behalf", to "the extent that customers have claims that have not been satisfied by either Weis in liquidation . . . or by SIPC" (A.203-A.204, A.223-A.224 (dissent)). As demonstrated hereinafter, that holding of the Court of Appeals majority is erroneous because (a) neither the common law doctrine nor Rule 17(a) confers upon the Trustee any right to assert customer rights of action (if any there be) under Section 17(a), and (b) *Caplin* v. *Marine Midland Grace Trust Co.,* 406 U.S. 416 (1972), precludes the Trustee from otherwise asserting such claims.

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issuance of instructions to segregate fully-paid securities or in obtaining possession or control of such securities pursuant to Rule 15c3-3. No evidence of theft or misappropriation of customer securities has been discovered." REDINGTON, REPORT OF THE TRUSTEE FOR THE LIQUIDATION OF THE BUSINESS OF WEIS SECURITIES, INC. 42 (December 8, 1977).

A. The Trustee Is Not Entitled As Bailee Of Customer Property To Assert Any Customer Rights of Action Under Section 17(a).

Under Section 6(b)(1) of SIPA, 15 U.S.C. §78fff(b)(1) (1970), the Trustee has the same title to property and rights as a bankruptcy or Chapter X trustee, and thus succeeded only to the rights of Weis itself, and not to any rights of the Weis customers that Weis itself could not assert. *See, e.g., Caplin* v. *Marine Midland Grace Trust Co., supra; In re Petroleum Corp. of America,* 417 F.2d 929 (8th Cir. 1969) (*see also* pp. 96-98, *infra*). Consequently, the Trustee may assert rights as purported "bailee" of customer property only to the extent that Weis itself was a "bailee" and could have asserted such rights.

The Trustee argued, and the Court of Appeals majority held, that the Trustee (having succeeded to the rights of Weis) "may sue on behalf of the customers/bailors any wrongdoer whom they could sue themselves" (A.203). That argument and that holding were purportedly based upon the common law doctrine of bailment, under which "[a] bailee may recover from a third person for the latter's wrongful injury to bailed property or disturbance of his possession thereof", 8 C.J.S. *Bailments* §39 at 474, and upon the provision of Rule 17(a), F.R. Civ. P., that permits a bailee to "sue in his own name without joining with him the party for whose benefit the action is brought" (*see* A.203-A.204). Analysis demonstrates, however, that, under the common law doctrine and Rule 17(a), the only bailment rights that the Trustee (as Weis' successor) may assert are *Weis' own rights* (and, of course, the Trustee has no Section 17(a) right of action for any alleged invasion of those rights, since Weis was regulated by, and not a beneficiary of, Section 17(a))—and *not any rights of the customers-bailors* (including the customers' purported rights of action under Section 17(a) against Touche

Ross). Moreover, the analysis demonstrates that it is totally inappropriate to refer to the common law doctrine of bailment to determine whether the Trustee may assert any federal Section 17(a) rights of the Weis customers.

1. THE COMMON LAW DOCTRINE REGARDING THE RIGHTS OF A BAILEE DOES NOT GIVE THE TRUSTEE ANY RIGHT TO ASSERT CUSTOMER RIGHTS OF ACTION UNDER SECTION 17(a).—The common law doctrine that permits a bailee (*e.g.*, Weis, or the Trustee as its successor) to sue a third party for loss of, or injury to, the bailed property is based upon *the bailee's own possessory rights,* and not upon any theory that the bailee is asserting the rights of the bailor *(e.g.,* customers of Weis). *See* W. PROSSER, LAW OF TORTS §15 at 94-95 (4th ed. 1971). As stated by Mr. Justice Holmes in his work on the common law, in early times the right to make use of possessory remedies "depended on possession, and not on ownership" and "was confined to the man in possession, and was not open to the owner unless he was that man". O. HOLMES, THE COMMON LAW 166 (1881). Thus, as Holmes explained,

> "[t]he meaning of the rule that all bailees have the possessory remedies is, that *in the theory of the common law every bailee has a true possession,* and that *a bailee recovers on the strength of his possession,* just as a finder does, and, as even a wrongful possessor may have full damages or a return of the specific thing from a stranger to the title" (emphasis added). *Id.* at 174.

Later, during the time of the Year Books, some confusion did develop as to whether a bailee's right to sue was based simply upon his possession or upon his liability over to the bailor, *id.* at 170, an issue that became of practical importance only after the decision in *Coggs* v. *Bernard,* 2 Ld. Raym. 909, 92 Eng. Rep. 107 (1704), which eliminated the bailee's absolute liability to the bailor, *see* 7

W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 451 (2d ed. 1937). However, the thorough analysis of English and nineteenth-century American[48] precedents set forth in the decision of the English Court of Appeal in the seminal case, *The Winkfield,* [1902] P. 42 (C.A.), "removed the confusion as to the real basis of the bailee's rights . . . [and] gave effect to the view, which Holmes had advocated, that *the bailee can sue because he is a possessor*" (emphasis added). 7 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW, *supra,* at 454-455 (also noting that "the [C]ourt of Appeal, in thus following Holmes, adopted the true historical view").[49] As the Court of Appeal stated in *The Winkfield,* "the wrongdoer . . . must treat the possessor as the owner of the goods *for all purposes* . . . . [T]he root principle . . . is that, as against a wrongdoer, possession is title. The chattel that has been converted or damaged is deemed to be *the chattel of the possessor and*

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[48] *Parish* v. *Wheeler,* 22 N.Y. 494 (1860); *Ullman* v. *Barnard,* 73 Mass. 554 (1856); *White* v. *Webb,* 15 Conn. 302 (1842). *See also Chamberlain* v. *West,* 37 Minn. 54, 33 N.W. 114 (1887); *Brewster* v. *Warner,* 136 Mass. 57, 49 Am. Rep. 5 (1883) (Holmes, J.).

[49] The holding of *The Winkfield* was that the bailee may recover the full value of the chattel simply on the strength of his possession and without regard to whether under the circumstances he would be liable for loss or destruction to the true owner, to whom he nonetheless must account for any recovery (*see also* pp. 88-89 n.50, *infra*), and that a full recovery by the bailee bars any action by the bailor. *The Winkfield* is the leading modern authority articulating the common law doctrine and the conceptual basis thereof, and is cited as such an authority in modern American cases. *See, e.g., Berger* v. *34th St. Garage, Inc.,* 274 App. Div. 414, 416, 84 N.Y.S.2d 348, 350 (1st Dep't 1948) ("The leading case on this subject which reviews the history of the doctrine is *The Winkfield*"), *mot. for leave to app. denied,* 275 App. Div. 660, 86 N.Y.S.2d 667 (1st Dep't 1949); *Luckenbach Steamship Co.* v. *United States,* 315 F.2d 598, 605 (2d Cir. 1963); *Paragon Oil Co.* v. *Republic Tankers, S.A.,* 310 F.2d 169, 175 (2d Cir. 1962), *cert. denied sub nom. Yacimientos Petroliferos Fiscales* v. *Paragon Oil Co.,* 372 U.S. 967 (1963); *American Surety Co.* v. *Baker,* 172 F.2d 689, 691 (4th Cir. 1949). *See generally* Comment, *A Re-examination of the Winkfield Case,* 9 FORDHAM L. REV. 247 (1940) ("The *Winkfield* case established the modern rule declaring the respective rights and liabilities existing within the legal triangle involving a bailor, the bailee and a third party who damages or converts the bailor's property while in the bailee's possession").

of no other" (emphasis added). [1902] P. at 54-55, 60. *See also* 1 F. HARPER & F. JAMES, LAW OF TORTS 98 (1956) ("[T]he possessor . . . is treated as though he were owner, i.e., as though he had the entire property interest in the goods. In other words, as against a 'stranger' . . . the person in possession *is* the owner").

Moreover, despite any confusion that once may have existed concerning the basis for the bailee's right to sue, it always has been clear under the common law doctrine that the rights that the bailee may assert as against a third person are *his own rights* arising from his possession, and that he may neither assert the bailor's personal rights nor purport to act as the bailor's legal representative. *See, e.g., Nash* v. *Lang,* 268 Mass. 407, 414, 167 N.E. 762, 765 (1929) ("*The bailee does not stand in the place of the bailor nor represent him.* He is not servant or agent of the bailor . . . . *The two have separate, distinct and independent rights and obligations* with respect to each other, and with respect to third persons"); *Green* v. *Clarke,* 12 N.Y. 343, 353 (1855) ("It is a general rule that a bailee having a special property and the general owner may either of them sustain an action for the conversion of or an injury to property in which they are interested. The right to sue is indispensable *to enable each to protect his particular interest*") (emphasis added).[50]

[50] The bailee's duty to account to the bailor for any recovery from a third party is not an element of the bailee's right to recover in the first instance, and that duty provides no basis for any attempt by the bailee to sue the third party on behalf of the bailor as the bailor's representative. The bailee's duty to account arises if he is able to recover *in his own right* the value of the property, and it then arises only *as a consequence* of that recovery, which the bailee holds in place of the property itself. In determining whether the bailee may recover from the third party, the law "is quite unconcerned with what the rights are between the bailor and bailee", and thus the bailee's "obligation to account to the bailor is really not ad rem in the discussion. It only comes in after he has carried his legal position to its logical consequence against a wrongdoer, and serves to soothe a mind disconcerted by the notion that a person who is not himself the complete owner should be entitled to receive back the full value of the chattel converted or destroyed". *The Winkfield, supra,* [1902] P. at 54, 60. *See also Berger* v. *34th St. Garage, Inc., supra,* 274 App. Div. at 420, 84 N.Y.S.2d at 353 ("[T]he words used in this complaint . . . that the suit was being brought on behalf of the owner of the property, is merely a statement of what the law requires of the plaintiff in the event of recovery . . . [T]he matter need not be pleaded because it is immaterial").

In light of the foregoing, even if common law principles be assumed to apply to implied rights of action under the 1934 Act (*but see* pp. 92-94, *infra*), the common law doctrine of bailment provides no basis for the Trustee to assert any private rights of action of the Weis customers under Section 17(a), for several reasons.

In the first place, any action brought by the Trustee (as successor to Weis) to recover as "bailee" of customer property necessarily is an action to vindicate Weis' *own possessory rights,* and not the rights of the customers-bailors. This means that denomination of the Trustee as a "bailee" does not give him any right of action under Section 17(a). As even the Court of Appeals majority recognized (*see* p. 84, *supra*), Weis itself, and therefore the Trustee, have no right of action under Section 17(a) to vindicate Weis' own rights, because Weis is a member of the class regulated by, rather than a member of the class protected, by Section 17(a). This was precisely the point made by Judge Mulligan (and missed by the majority in failing to understand that a "bailee" asserts *his own possessory interest* and not any of his bailor) when he emphasized that, "I fail to see how denominating [the Trustee] a bailee adds a jot or a tittle to his statutorily created status as the representative of Weis—an entity regulated by, and precluded from suing under, the Act" (A.224).

The Trustee cannot avoid that simple and dispositive point by arguing that the bailed property actually belongs to the customers-bailors and that they satisfy the necessary condition of membership in the class protected by Section

17(a). The common law doctrine does not permit a bailee who cannot demonstrate satisfaction of an essential condition for recovery to circumvent such a condition by asserting (as the Trustee does here) that the bailor could satisfy it, and that any recovery by the bailee will be held in trust for the bailor. For example, while a bailee must show his own freedom from contributory negligence to recover on a claim for the defendant's negligent injury to the property, the bailee's contributory negligence will not be imputed to the bailor so as to bar recovery by the bailor against the defendant. *See generally* W. PROSSER, LAW OF TORTS, *supra,* §74 at 491 (noting that old cases that imputed such negligence to the bailor have been overruled because of "modern acceptance of the interests of the bailor and the bailee as quite separate and distinct"). In such circumstances, a negligent bailee cannot circumvent the requirement that he establish his own freedom from contributory negligence by arguing that the bailor could satisfy that requirement, and that any recovery will be held in trust for the bailor.[51] *See also* pp. 88-89 n.50, *supra.*

Significantly, the Trustee's "bailee" claim perverts the basic rationale of the common law doctrine. As shown hereinabove, under the common law doctrine the true ownership of the property is not given any real signifi-

[51] *Cf. Commercial Banking Corp.* v. *Philadelphia Transp. Co.,* 162 Pa.Super. 158, 56 A.2d 344 (1948) (bailee's insurer could not avoid defense of bailee's contributory negligence by bringing suit in bailor's name); RESTATEMENT OF RESTITUTION §94 and Comment b, Illustration 4 (1937)(negligent bailee who has paid owner for damage is not entitled to restitution from third person whose negligence also caused the damage, because the bailee could not "have recovered from the third person for an injury so caused to himself or to his own property"). *See also Harvard Trust Co.* v. *Racheotes,* 337 Mass. 73, 147 N.E.2d 817, 819 (1958) (contributorily negligent chattel mortgagor, whose rights were similar to those of a bailee, could not recover his own damages by virtue of chattel mortgagee's ability to sue despite that negligence, because otherwise it "would be permitting [the mortgagor] to accomplish indirectly what he could not accomplish directly . . . [and] to reap benefits to which, had there been no mortgage, he would not be entitled").

cance in an action between the possessor and a wrongdoer, and the possessor is treated by virtue of his possession as though he were owner. The bailee thus recovers on the strength simply of his possession, and the wrongdoer is not permitted to plead as a defense the right of the owner unless he claims under it. Here, however, since only the Weis customers (and not Weis itself) have any rights of action implied from Section 17(a), the Trustee can maintain this action only by emphasizing, rather than (as under the common law doctrine) disregarding, the true ownership.

Consequently, if common law principles applied, they would treat Weis as owner of the bailed property, and would give to the Trustee none of the bailors' personal rights derived from their protected status as customers. Under those principles the Trustee would have no greater rights with respect to the bailed property than he would have if the property actually had belonged to Weis itself, and would not be able to assert customer rights of action under Section 17(a).

Even aside from the foregoing considerations, it is erroneous to treat the question of whether the Trustee may assert any Section 17(a) rights of action accruing to the Weis customers as governed by the rights of a bailee to sue for loss or injury to bailed property. As the cited authorities show, the bailee's rights arise because of actual interference by a third party with its possession of tangible property (*e.g.*, interference by conversion of or physical damage to the property), whereas any Section 17(a) rights of action of the Weis customers are not rights of action for such interference with possessory rights, but are instead personal rights to recover for injury arising out of a relationship to which the statute provides special protection. The Section 17(a) rights accrue (if at all) only to customers because of their membership in the limited class

for the special benefit of which Section 17(a) was enacted—not because of their possession, or delivery of possession, of tangible property. They may be asserted against a defendant such as Touche Ross only because it has allegedly breached a duty that it owes to that limited class alone—and not because it has interfered with any possessory interests.

Any Section 17(a) right of action therefore is completely unlike the rights of action usually asserted by bailees (such as, for example, for conversion or physical damage), which are available generally, rather than to a special class, and which may be asserted by any possessor of property in his own right simply because he has possession and because the defendant has interfered with that possession and thereby breached a duty that he owes to the actual possessor. Consequently, any Section 17(a) right of action is completely outside of the scope of the common law doctrine permitting a bailee to sue for trespass upon or injury to bailed property.

Finally, while the common law doctrine of bailment thus provides no basis for the Trustee to assert any Section 17(a) rights of action of the customers, the common law doctrine would not under any circumstances be determinative here because " 'the extent and nature of the legal consequences of [a violation of Section 17(a)] . . . are nevertheless federal questions' ", as are the incidents of any implied right of action therefor. *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433, *quoting Sola Electric Co.* v. *Jefferson Electric Co.,* 317 U.S. 173, 176 (1942); *cf. Stella* v. *Kaiser,* 221 F.2d 115 (2d Cir.) (effect of release on claim under the 1934 Act is a question of federal law), *cert. denied,* 350 U.S. 835 (1955); *Globus, Inc.* v. *Law Research Service, Inc.,* 318 F.Supp. 955, 958 n.2 (S.D.N.Y. 1970) (indemnity and contribution), *aff'd,* 442 F.2d 1346 (2d Cir.), *cert. denied sub nom. Law Research Service, Inc.* v. *Blair & Co.,* 404 U.S. 941 (1971).

Consequently, whether a bailee of customers' property who himself is not a customer has a Section 17(a) right of action is a question to be decided under the substantive principles governing construction of the federal securities laws. As made clear in *Piper* v. *Chris-Craft Industries, Inc., supra,* implied rights of action under the 1934 Act do not exist in the abstract; rather, the question of who may assert such a right of action is fundamental to the determination of whether any implied right of action exists at all. *See also Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 64 (the issue correctly characterized was whether plaintiff stated a "claim for relief" under Section 6, not whether he had "standing" to do so). A mere bailee of customers' property is not an intended beneficiary of Section 17(a), particularly where the bailee is a brokerage firm (*e.g.,* Weis) belonging to the very class whose conduct is regulated thereby. Nor is it necessary in order to effectuate the congresssional purpose to give a right of action for violation of Section 17(a) to such a bailee (to whom there are available adequate state law remedies for any interference with his possessory interests), especially where his own wrongdoing has led to his alleged injury. *See also Miller* v. *New York Produce Exchange,* 550 F.2d 762, 768-769 (2d Cir. 1977) (bankruptcy trustee of defunct brokerage firm cannot recover for violations of Commodity Exchange Act from defendant whose "only sin is its failure to prevent transgressions by the plaintiff"). The federal principles governing the implication of implied rights of action under the 1934 Act therefore require a holding that such a bailee may not

assert such rights, irrespective of the common law doctrine.[52]

2. RULE 17(a), F.R.CIV.P., DOES NOT GIVE THE TRUSTEE ANY RIGHT TO ASSERT CUSTOMER RIGHTS OF ACTION UNDER SECTION 17(a).—In a ruling apparently of first impression, the Court of Appeals majority relied upon Rule 17(a), F.R. Civ. P. (as amended in 1966) in holding that the Trustee may sue as the "bailee" of customers' property (A. 203-204). That reliance and that holding are erroneous, because Rule 17(a) provides only procedural, and not substantive, rights.

Rule 17(a), which requires an action to be prosecuted in the name of the "real party in interest", provides that "[a] bailee . . . may sue in his own name without joining with him the party for whose benefit the action is brought". The Advisory Committee Notes to Rule 17(a) make clear that it only restates the common law doctrine permitting a bailee to sue for interference with his possessory interest, stating that the purpose of the 1966 amendment was

> "[to add] to the illustrative list of real parties in interest a bailee—meaning, of course, a bailee suing on behalf of the bailor with respect to the property bailed. (When the *possessor* of property other than the owner sues *for an invasion of the possessory interest* he is the real party in interest.)" (emphasis added). 39 F.R.D. at 84-85.

Professor Moore emphasizes that the "real party in interest" is *"the party who, by the substantive law, has the right sought to be enforced"*, 3A MOORE'S FEDERAL PRACTICE ¶17.02 at 17-13, ¶17.07 at 17-65 (2d ed. 1978). He also points out that the 1966 amendment to Rule 17(a) was simply procedural and has no substantive effect:

> "[t]his amendment was declaratory of existing admiralty and civil practice . . . . However, the declaration of *this procedural rule should not affect various substantive rules* which control the three-way relationship between the bailor, the bailee, and the third party" (emphasis added). *Id.*, ¶¶17.12 at 17-153-17-154.

See also 6 C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE §1548 at 676-677 ("In 1966, the word 'bailee' was added to Rule 17(a). This represents a codification of the admiralty practice . . . . The underlying rationale for the inclusion of the reference to 'bailee' is that when someone in possession of property sues for an injury to the property, he is the real party in interest even though he may not be the owner of the goods.").

Consequently, Rule 17(a) merely provides procedural authority for the Trustee to assert whatever substantive rights he may have to sue as "bailee". Since, as demonstrated hereinabove, the Trustee has no such substantive right to assert any Section 17(a) rights of action of the customers, Rule 17(a) does not provide any basis for the Trustee to maintain this action.

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[52] To the extent that this Court, in deciding as a matter of federal law whether to permit a bailee who is not an intended beneficiary of Section 17(a) to assert any implied private right of action thereunder, might consider the common law doctrine as a source of guidance, it should be noted that the common law doctrine has been criticized to the extent that it permits a bailee to recover beyond his own interest without the consent of the owner to bring the action. This is because, among other reasons, the bailee, even though he is required to account to the owner for any recovery, may not be able properly to represent the owner's interests. *See, e.g., Panama Canal Co.* v. *Stockard & Co.*, 391 Pa. 374, 137 A.2d 793 (1958) (requiring bailor's consent); W. PROSSER, LAW OF TORTS § 15 at 95 (4th ed. 1971); Warren, *Qualifying as Plaintiff in an Action for a Conversion*, 49 HARV. L. REV. 1084, 1097-1099 (1936); Comment, *A Re-examination of the Winkfield Case*, 9 FORDHAM L. REV. 247 (1940). *See also* p. 98, *infra* (Trustee's inadequacy as customers' class representative).

B. *Caplin* v. *Marine Midland Grace Trust Co.* Precludes The Trustee From Otherwise Asserting Any Customer Rights Of Action Under Section 17(a).

Even aside from the fact that the Trustee is not entitled as a purported "bailee" to assert any Section 17(a) rights of action of the Weis customers, he is not otherwise entitled to assert any such rights. *Caplin* v. *Marine Midland Grace Trust Co., supra,* establishes the principle that a bankruptcy or Chapter X trustee, and therefore the Trustee here, is not a proper party to assert claims of the Weis customers (who are, of course, creditors of Weis to the extent that their claims against Weis are unsatisfied). *Caplin* held that the Chapter X trustee of a corporation has no standing to assert claims on behalf of any particular class of creditors (there, holders of its debentures) against third parties, because

> "[i] nowhere in the statutory scheme is there any suggestion that the trustee . . . is to assume the responsibility of suing third parties on behalf of debenture holders . . . . [ii] [the corporation] could [not] make any claim . . . [and thus] any suit by debenture holders would not affect the interests of other parties to the reorganization . . . [iii] a suit by him on behalf of debenture holders may be inconsistent with any independent actions that they might bring themselves." 406 U.S. at 428-432.

Caplin compels the conclusion here that the Trustee may not sue on behalf of any particular class of creditors of Weis, including the class specified by the Court of Appeals majority, *viz.,* those Weis customers whose claims against Weis for their property have not been satisfied.

In the first place, as in *Caplin,* there is no statutory authorization for any such suit. While the Court of Appeals majority did not purport to find any statutory

authority for the Trustee to assert claims belonging to customers, in sustaining the Trustee's bailee argument it did assert that the Trustee "is responsible for marshalling and returning [customers'] property" (A. 203). However, none of the provisions of SIPA requiring the Trustee to marshal and return customers' property authorizes the Trustee to assert claims that belong uniquely to the customers. *See* 15 U.S.C. §§78fff(a)(1), 78fff(c)(2)(B), 78fff(c)(2)(C)(1970); *cf. Caplin* v. *Marine Midland Grace Trust Co.,* 439 F.2d 118, 123 (2d Cir. 1971) ("[A] trustee appointed . . . 'with the title of the bankrupt' [succeeds] to eight types of property . . . . None of these, by the remotest stretch of language or even of imagination, could include the claims of the debenture holders against an indenture trustee for permitting the debtor to violate convenants made by the debtor . . . for the bondholders' protection"), *aff'd,* 406 U.S. 416 (1972). While the "single and separate fund" of customer property defined in Section 6(c)(2)(B) of SIPA, 15 U.S.C. §§78fff(c)(2)(B)(1970), does include "the proceeds of all customers' property transferred by the debtor", any customer claims against Touche Ross for violation of Section 17(a) are not claims that may be asserted by the Trustee to recover any fraudulent or voidable transfer of such property and cannot "by the remotest stretch of language or even of imagination" properly be characterized as "proceeds" of such property.

Second, any recovery by the Trustee would be on behalf of the customers only and would be of no benefit to other general creditors, since, as this Court observed in *Caplin,* the customers can prove in the liquidation the full amount of their claims and may recover from Touche Ross only to the extent that their claims are not satisfied in the liquidation. 406 U.S. at 430-431. Also, although Touche Ross would not be required to pay to the custom-

ers any amount in excess of that deficiency, any such excess payment would, under the Second Circuit's holding in *Caplin*, subrogate Touche Ross to the customers' claims against the Weis general estate. *See id.* at 430; *cf. Morgan* v. *Graham*, 228 F.2d 625, 628 (10th Cir. 1956).

Third, there would be a proliferation of litigation since Weis' customers can sue—indeed, already have sued (see p. 16 n.12, *supra*)—Touche Ross; the Trustee may be unable to bind the customers to any settlement; and the Trustee would be inappropriate as the customers' class representative, since he has no common interest with them and may have conflicting interests, in view of his obligations to general creditors and others. One source of such conflicting interests would be the fact that, to the extent that Touche Ross might be held liable to the customers, it would have a claim against Weis as a joint tortfeasor for indemnification or contribution based upon Weis' filing of Section 17(a) reports that were false and contained the misstatements that Touche Ross failed to discover. Of overriding significance, however, is the fact, recognized by Judge Mulligan's dissent (A.224), that such proliferation of litigation is *unnecessary*. *See also Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 67 (holding it impermissible for a receiver of a brokerage firm to sue where the brokerage firm could not, even though any recovery would be for the benefit of public investors, because "those investors already have a cause of action in their own right . . . and the receiver's suit would add nothing to their rights").

IV

Even If (As The Court Of Appeals Majority Held) Section 17(a) Does Create An Implied Private Right Of Action In Brokerage Firm Customers Against Accountants, SIPC May Not Assert Such Implied Right As Subrogee Of Weis Customers For The Payment Of Whose Claims It Has Advanced Funds To The Trustee

SIPC has sought to recover damages (*viz.*, the $14,000,000 by which the "SIPC fund" allegedly was "depleted") on two different theories. First, SIPC has sought to recover such damages in its own right, on the theory that Section 17(a) imposes upon accountants duties which Touche Ross owed directly to SIPC and for the breach of which SIPC as an intended beneficiary has an implied private right of action. Second, SIPC has sought to recover such damages as subrogee of customers for the payment of whose claims SIPC advanced funds to the Trustee, on the theory that the customers as intended beneficiaries of Section 17(a) have an implied private right of action and that SIPC, upon advancing such funds, became subrogated to their right of action.

The Court of Appeals majority and Judge Mulligan agreed that SIPC in its own right cannot assert any implied right of action for violation of Section 17(a), because "it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or 1970" (A.201 n.13, A.222-A.223 (dissent)). That clearly correct holding is not presently before this Court.[53]

However, the Court of Appeals majority held, over Judge Mulligan's dissent, that SIPC as "subrogee" could

[53] SIPC's conditional cross-petition in No. 78-526, which is apparently still *sub judice*, seeks review of that holding.

assert the Section 17(a) right of action of the Weis customers by reason of "SIPC's general common-law right of equitable subrogation" (A.201-A.202, A.223 (dissent)). As demonstrated hereinafter, that holding is erroneous because (a) Section 6(f)(1) of SIPA expressly sets forth SIPC's exclusive subrogation remedy, by which SIPC is subrogated only to the customer "claims" *against the Weis estate,* and (b) the limitation of SIPC's subrogation rights to those enumerated in SIPA also is required by the statutory scheme and general equitable principles.

A. Section 6(f)(1) Of SIPA, By Which SIPC Is Subrogated Only To Customer Claims Against The Weis Estate, Is Exclusive And Precludes SIPC From Subrogation To Any Customer Rights Of Action Under Section 17(a) Against Touche Ross.

SIPC was created by and its powers are specified in SIPA, which establishes a comprehensive statutory scheme for brokerage firm liquidations. The only subrogation rights provided to SIPC by SIPA are set forth in Section 6(f)(1), as follows:

> "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be *subrogated to the claims of such customers with the rights and priorities provided in this section"* (emphasis added). 15 U.S.C. §§78fff(f)(1)(1970).

As the Court of Appeals majority and Judge Mulligan in dissent correctly held (A.202, A.223), Section 6(f)(1) subrogates SIPC, when it advances funds to pay "claims" of the Weis customers, only to the "claims" of such customers *against the estate of the brokerage firm (i.e., the Weis estate).*[54]

[54] The "claims" to which SIPC is subrogated under section 6(f)(1) include only claims of customers against the estate of the debtor (*i.e.,* Weis). The term "claims" is used uniformly throughout Section 6 of SIPA to include claims against the debtor's estate only, and it is a settled principle of statutory construction that when the same word or phrase is used in the same section of a statute more than once, and the meaning is clear in one place, it will be construed to have the same meaning in the other places. *E.g., Meyer* v. *United States,* 175 F.2d 45, 47 (2d Cir. 1949); *United States* v. *Vargas,* 380 F.Supp. 1162, 1166 (E.D.N.Y. 1974); *cf. United States* v. *Cooper Corp.,* 312 U.S. 600, 606 (1941) (different sections of same act). Section 6(f)(1) itself, which provides that SIPC is "subrogated to the *claims* of such customers", makes clear that "the claims" to which SIPC is subrogated are "the claims of customers" which are referred to in the introductory clause and for payment of which "moneys are advanced by SIPC to the trustee". To include within the term "claim" causes of action against persons other than the debtor would render totally inapposite the qualification in Section 6(f)(1) that "SIPC shall be subrogated . . . *with the rights and priorities provided in this section*" (emphasis added), and also would conflict with the express definition in the Bankruptcy Act of the term "claims"—a definition which is pertinent, if not controlling, under SIPA. *See* Section 6(c)(1) of SIPA, 15 U.S.C. § 78fff(c)(1)(1970). Section 106(1) of the Bankruptcy Act, 11 U.S.C. §506(1), defines "claims" as follows: "claims shall include all claims of whatever character *against a debtor or its property,* except stock" (emphasis added). *See* 6 W. COLLIER, BANKRUPTCY ¶ 2.05 at 307 (14th ed. 1978) ("To come within the terms of § 106(1) . . . it is *essential that the claim in question be predicated against either the debtor or the debtor's property*" (emphasis added)).

In light of the comprehensive statutory scheme of SIPA, Congress clearly intended that the sole express statutory provision in Section 6(f)(1) for subrogation of SIPC to customer "claims" against the brokerage firm estate be SIPC's exclusive subrogation remedy, and that SIPC's subrogation rights not extend to customer rights of action against third parties. *See, e.g., Amtrak, supra,* 414 U.S. at 458 (requiring application of *expressio unius* doctrine because "when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies"); *Securities Investor Protection Corp.* v. *Barbour, supra; Rogers* v. *National Surety Co.,* 116 Neb. 170, 216 N.W. 182 (1927) (under statute establishing a "depositors' guaranty fund", express provision subrogating such fund to the rights of creditors paid by the fund to participate in the defunct bank's assets held, under *expresssio unius* doctrine, to be the fund's exclusive subrogation remedy); pp. 41-43, *supra. See also* H.R. REP. NO. 91-1613,

reprinted in [1970] U.S. CODE CONG. & AD. NEWS 5254, 5262 ("It is . . . contemplated that, when the liquidation proceedings are completed, SIPC will receive back some moneys *from the trustee*" (emphasis added)).

Thus, SIPC has no subrogation rights against any third party (*e.g.*, Touche Ross) whom the Weis customers could sue, under Section 17(a) or otherwise. The contrary holding by the Court of Appeals majority conflicts with this Court's decisions requiring application of the *expressio unius* doctrine and would circumvent the intent of Congress as expressed in SIPA. As Judge Mulligan's dissent emphasizes, SIPC is "a congressionally created corporation with limited powers to litigate" (A.223), and has only the subrogation rights expressly provided by SIPA.

B. The Limitation Of SIPC's Subrogation Rights To Those Enumerated In SIPA Also Is Required By The Statutory Scheme And General Equitable Principles.

The Court of Appeals majority rationalized its holding that SIPC is subrogated to customer rights of action against Touche Ross for violation of Section 17(a) on three purported grounds, *viz.*, (i) "SIPC's general common-law right of equitable subrogation", (ii) "the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC", and (iii) "the intent of Congress . . . that SIPC be able to recoup its losses from solvent wrongdoers" (A.202). As shown hereinafter, each of those grounds is fallacious, and there thus is no acceptable basis for the majority's holding.

1. As is the case in determining whether the Trustee as "bailee" can assert any Section 17(a) right of action (*see* pp. 92-94, *supra*), the question whether SIPC as "subrogee" may assert any such right is a question to be decided as a matter of substantive federal securities law.

Under the analysis required by *Piper* v. *Chris-Craft Industries, Inc., supra*, whether it is necessary to permit a particular party to assert such a right is a question that must be considered in the first instance, and is not a secondary question to be decided under general common-law principles after the right may be found to exist in the abstract. Even if it be assumed that the *expressio unuis* doctrine is not controlling here, subrogation rights other than those expressly set forth in SIPA should be recognized, if at all, only if it is necessary for the effectuation of the primary legislative purpose.

Moreover, even if the question of subrogation here were governed by the "general rule", relied upon by the Court of Appeals majority, that "upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss" (A.202, *quoting* 31 N.Y. JURISPRUDENCE *Insurance* §1620 at 510), a court in applying that rule would be required first to determine whether it is necessary, in order to effectuate Congressional goals, to imply a Section 17(a) private right of action on behalf of customers to recover losses for which SIPC is required to compensate them pursuant to SIPA, where the only beneficiary of implying such a right in reality will be SIPC (if its right to subrogation is upheld), rather than the customers. That question is of course distinguishable from the question whether customers should have an implied right of action for losses for which SIPC is not required to compensate them, where the real beneficiary of any recovery would be the customers themselves rather than SIPC. If it were to be decided, as it should be, that customers have no implied private right of action for a third party's violation of Section 17(a) for losses for which SIPC has com-

pensated them, then even under the general common-law rule there would be no claim that SIPC could assert as subrogee against the third party.

Whatever the approach, the pertinent considerations require a holding that SIPC may not sue here as "subrogee". Those considerations are in large part the same as the considerations that require the holding that SIPC in its own right may not assert any Section 17(a) right of action, because permitting SIPC to sue as subrogee simply would make the holding with respect to SIPC's entitlement to sue in its own right illusory. Congress enacted SIPA to provide additional protection to customers of securities brokerage firms in accordance with a comprehensive statutory scheme that expressly sets forth in detail the precise protection that Congress thought to be necessary and appropriate, an important aspect of which is SIPC's responsibility to advance funds for the payment of customers' claims (*see* p. 62 n.37, *supra*). SIPA also sets forth the precise and limited subrogation rights that SIPC shall have upon advancing those funds (*see* pp. 100-102, *supra*). Once customers have received the SIPC funds to which they are entitled, they have received the protection that Congress thought necessary, and which Congress created SIPC in order to provide. At that point, it is not necessary in order to effectuate the Congressional purpose of providing protection to customers to imply any private right of action for violation of Section 17(a), either on their behalf or on behalf of SIPC as subrogee. The only purpose of implying such a right of action and recognizing SIPC's subrogation thereto would be to benefit SIPC, not the customers. *Cf. Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co., supra,* 417 U.S. at 713 (courts should "look . . . to the true substance of the claims and the actual beneficiaries . . . . piercing all fictions and disguises").

Furthermore, the result of permitting SIPC to sue as "subrogee" would be to transfer from SIPC (and the brokerage firms generally that are required to contribute to the "SIPC fund") to a third party such as Touche Ross the burden of providing the financial protection to customers that Congress specifically created SIPC in order to provide. However, SIPC is not a "beneficiary" of the 1934 Act and the primary legislative purpose obviously was not to benefit SIPC. In creating SIPC, as in enacting the 1934 Act itself, Congress spoke of directly benefiting public investors only. *See, e.g.,* 116 CONG. REC. 39350 (1970) (remarks of Rep. Moss). The statutory scheme enacted by Congress creates "a unique pattern of regulation combining both industry and government responsibility". S. REP. NO. 94-75, 94th Cong., 1st Sess. 22, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 201. Concomitant with the delegation to the securities industry of substantial self-regulatory responsibilities, Congress, by enacting SIPA and creating the "SIPC fund", imposed the risks of brokerage firm failure on the industry generally and thereby created an incentive for SIPC and the industry to perform their responsibilities diligently. To shift that risk from SIPC to accountants would eliminate those incentives and thereby undermine the statutory purposes.

The provision of Section 6(f)(1) of SIPA by which SIPC is subrogated only to customer claims against the debtor's estate therefore is entirely consistent with the Congressional intent that SIPC (and the brokerage firms which contribute to its "fund") bear the responsibility and burden of providing to the customers the protection that Congress specified they are to receive under SIPA, and that SIPC and the industry not delegate their duties to prevent brokerage firm failures and the risks thereof to accountants. To permit SIPC to sue here as subrogee therefore requires not only the granting to SIPC of subrogation rights in addition to those expressly specified

in Section 6(f)(1) of SIPA, but also requires shifting the burden of providing the protection that Congress thought necessary from the party (SIPC) that Congress expressly charged with the duty to provide such protection to another party (Touche Ross) of whom Congress made no mention (*see also* p. 79, *supra*).

Subrogation is an equitable remedy, and should be unavailable to SIPC here unless without it Touche Ross will be "unjustly enriched" at SIPC's expense. *See* RESTATEMENT OF SECURITY § 141 (1941); RESTATEMENT OF RESTITUTION §162 (1937). Touche Ross will not be "unjustly enriched" should SIPC, and not Touche Ross, ultimately bear the burden of providing the protection to customers that SIPC was created by Congress in order to provide. More significantly, in order to effectuate Congress' goals, it is not "necessary" to shift that burden from SIPC to Touche Ross.

2. It was error for the Court of Appeals majority to have spoken of any "windfall benefit [to Touche Ross] from the existence of SIPC" (A.202). The damages that SIPC seeks to recover are not damages that, but for the existence of SIPC, Touche Ross would have been required to pay, because SIPC's theory is that Touche Ross' negligence and malpractice impeded the operation of the "early warning system" that SIPC is required to maintain, and that if SIPC had not thereby been prevented from properly monitoring Weis' financial condition, the damages for which SIPC sues might never have occurred. While it may be assumed that Congress hoped that the regulatory scheme, including the "early warning system", would achieve its objectives, there is no evidence that it intended that accountants who audit Section 17(a) reports should be liable, upon the regulatory scheme's failure to achieve those objectives, for damages that might have been avoided had it functioned more adequately. Permitting SIPC to recover those damages therefore would impose onerous new liabilities on accountants such as Touche Ross.

There is another reason why it is specious to talk of a "windfall" for Touche Ross. If Touche Ross' negligence and malpractice actually were the proximate cause of Weis' failure, the State courts can be expected to award to the Trustee, and to require Touche Ross to pay, those damages to which the Trustee (as Weis' successor) is entitled. The Weis estate thereby will be augmented to the extent that Touche Ross may be responsible for the Weis debacle. SIPC, as subrogee of customer claims *against the Weis estate,* will share in the distribution of the assets of that estate to the extent that it is entitled. There is no evidence that Congress intended that SIPC have any greater rights, or Touche Ross any greater liability.

3. The Court of Appeals majority also erred by premising its subrogation holding upon a purported "intent of Congress . . . that SIPC be able to recoup its losses from solvent wrongdoers" (A.202). The majority cited no evidence of that purported Congressional intent, and, in fact, there was no such intent. The express provisions of SIPA giving SIPC the right to recoup its losses refer only to SIPC's right to receive payments from the single and separate fund or the general estate of the debtor, and not from third parties. *E.g.,* 15 U.S.C. §§ 78fff(c)(2)(B)(i), 78fff(c)(2)(B)(ii), 78fff(f)(1) (1970). The legislative history sets forth the actual Congressional intention that any recoupment by SIPC would be from the debtor's estate and not from third parties such as Touche Ross, with the House Report on the bill that became SIPA stating that

> "It is, of course, hoped and contemplated that, when the liquidation proceedings are completed, SIPC will

receive back some moneys *from the trustee"* (emphasis added). H.R. REP. NO. 91-1613, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5254, 5262.[55]

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

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[55] The only authority cited by the majority (A.202) that discusses SIPC's subrogation rights is *dictum* in *Securities & Exchange Commission* v. *Albert & Maguire Securities Co.*, 560 F.2d 569, 574 (3d Cir. 1977), for which the Third Circuit offered no authority or supporting analysis, and which in fact was inconsistent with the theory under discussion there, *viz.*, that the Trustee might have the power to obtain and sue upon assignments of customer rights of action.

APPENDIX

STATUTES AND RULES

Securities Exchange Act of 1934

Section 17(a), 15 U.S.C. § 78q(a), as in effect prior to the Securities Acts Amendments of 1975, Pub. L. 94-29 (June 4, 1975):

"Accounts and Records, Reports, Examinations of Exchanges, Members, and Others

"SECTION 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

Section 18(a), 15 U.S.C. § 78r(a):

"Liability for Misleading Statements

"SECTION 18. (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration state-

ment as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisidiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant."

Securities Investor Protection Act of 1970

Section 6(b)(1), 15 U.S.C. § 78fff(b)(1):

"(1) Trustee powers.—A trustee appointed under section 5(b)(3) (hereinafter referred to as "trustee") shall be vested with the same powers and title with respect to the debtor and the property of the debtor, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under chapter X of the Bankruptcy Act have with respect to a bankrupt and a chapter X debtor. . . ."

Section 6(f)(1), 15 U.S.C. § 78fff(f)(1):

"(f) SIPC advances to trustee.—

(1) Advances for customers' claims.—In order to provide for prompt payment and satisfaction of the net equities of customers of debtor,

SIPC shall advance to the trustee such moneys as may be required to pay or otherwise satisfy claims in full of each customer, but not to exceed $50,000 for such customer; except that—

(A) insofar as all or any portion of the net equity of a customer is a claim for cash, as distinct from securities, the amount advanced by reason of such claim to cash shall not exceed $20,000;

(B) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(C) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any claims of any customer who is a general partner, officer, or director of the debtor, the beneficial owner of 5 per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights) or limited partner with a participation of 5 per centum or more in the net assets or net profits of the debtor; and

(D) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy claims of any customer who is a broker or dealer or bank other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank or otherwise, that claims of such broker or dealer or bank against the debtor arise out of transactions for customers of such broker or dealer or bank, in

which event, each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

"To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section."

SEC Rules

Rule 17a-5, 17 C.F.R. § 240.17a-5, as in effect prior to SEC revisions of 1975, 40 F.R. 59712-17 (Dec. 30, 1975):

"§ 240.17a-5 Reports to be made by certain exchange members, brokers and dealers.

"(a) *Filing reports.* (1) This rule shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer registered pursuant to section 15 of the act.

(2) Every member, broker or dealer subject to this rule shall file reports of financial condition containing the information required by Form X-17A-5, as follows: (i) A report shall be filed as of a date within each calendar year, except that *(a)* the first such report of a member, broker or dealer (other than one succeeding to and continuing the business of another member, broker or dealer) shall be as of a date not less than one nor more than five months after the date on which such member, broker or dealer becomes subject

to this rule (in the case of a registered broker or dealer this shall be the date the registration becomes effective) and *(b)* a member, broker or dealer succeeding to and continuing the business of another member, broker or dealer need not file a report as of a date in the calendar year in which the succession occurs if the predecessor member, broker or dealer has filed a Form X-17A-5 report in compliance with this rule as of a date in such calendar year; (ii) such reports shall be filed not more than 45 days after the date of the report of financial condition; and (iii) reports for any two consecutive years shall not be as of dates within four months of each other. The reports provided for in this rule shall be filed in duplicate original with the Regional Office of the Commission for the region in which the member, broker or dealer has his or its principal place of business.

(b) *Nature and form of reports.* Each report of financial condition filed pursuant to paragraph (a) of this section shall be prepared and filed in accordance with the following requirements:

(1) The report of a member, broker or dealer shall be certified by a certified public accountant or a public accountant who shall be in fact independent: *Provided, however,* That such report need not be certified if, since the date of the previous financial statement or report filed pursuant to § 240.15b1-2 or this section, (i) said member has not transacted a business in securities directly with or for other than members of a national securities exchange; has not carried any margin account, credit balance or security for any person other than a general partner; and has not been required to file a certified financial statement with any national securities exchange; or (ii) his

or its securities business has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or (iii) his or its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed of trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance, or security for any securities customer. A member, broker or dealer who files a report which is not certified shall include in the oath or affirmation required by paragraph (b) (2) of this section a statement of the facts and circumstances relied upon as a basis for exemption from the certification requirements.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, (i) the financial statement and supporting schedules are true and correct and (ii) neither the member, broker, or dealer, nor any partner, officer, or director, as the case may be has any proprietary interest in any account classified solely as that of a customer. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer

(3) If the schedules furnished pursuant to the requirements of items (a), (b), and (c) of part II

and the supplementary accountant's certificate furnished pursuant to the audit requirements of Form X-17A-5 are bound separately from the balance of the report, they shall be deemed confidential, except that they shall be available for official use by any official or employee of the United States or any State, by national securities exchanges and national securities associations of which the person filing such report is a member, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this paragraph shall be deemed to be in derogation of the rules of any national securities association or national securities exchange which give to customers of a member, broker or dealer the right, upon request to such member, broker, or dealer, to obtain information relative to his financial condition.

(c) *Use of certain statements filed with the Securities and Exchange Commission, State Commissions and National Securities Exchanges.* (1) Any member, broker, or dealer who is subject to the provisions of paragraph (a) of this section may file in lieu of the report required by that paragraph a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member, or with any agency of any State as a condition of doing business in securities therein, *Provided,* That (i) the copy so included reflects his financial condition as of a date not more than 45 days prior to the filing thereof with the Commission, and (ii) the report, as filed with this Commission, meets the requirements of this rule and Form X-17A-5 and contains the information called for by that form.

(2) At the request of any member, broker, or dealer who is (i) an investment company registered under the Investment Company Act of 1940, or (ii) a sponsor or depositor of such a registered investment company who effects transactions in securities only with, or on behalf of, such registered investment company, the Commission will accept any statement of his financial condition filed pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934 or section 30 of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder as a filing pursuant to this rule. Such a filing shall be deemed to satisfy the requirements of this rule for any calendar year in which such a financial statement is filed, *Provided*, That the statement so filed meets the requirements of the other rules under which it is filed with respect to time of filing and content.

(d) *Extension of time for filing reports.* In the event any member, broker, or dealer finds that he cannot file his report for any year within the time specified in paragraph (a) or (c) of this section without undue hardship, he may file with the Commission an application for an extension of time to a specified date which shall not be more than 90 days after the date as of which his financial condition is reported. The application shall state the reasons for the requested extension and shall contain an agreement to file the report on or before the specified date. The application shall be deemed granted unless the Commission, within ten days after receipt thereof, enters an order denying the application.

(e) *Exemptions.* Any "bank", as defined in section 3(a)(6) of the Act (48 Stat. 882; 15 U.S.C. 78c) shall be exempt from the provisions of this section.

(f) *Qualifications of accountants.* The Commission will not recognize any person as a

certified public accountant who is not a duly registered and in good standing as such under the laws of his place of residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(g) *Accountant's certificate*—(1) *Technical requirements.* The accountant's certificate shall be dated, shall be signed manually, and shall identify without detailed enumeration the items of the report covered by the certificate.

(2) *Representations as to audit.* The accountant's certificate (i) shall contain a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers, and including, if with respect to significant items in the report covered by the certificate any auditing procedures generally recognized as normal have been omitted, a specific designation of such procedures and of the reasons for their omission, (ii) shall state whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances; and (iii) shall state whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case.

(3) Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (h) of this section.

(h) *Accountant's certificate; options to be expressed.* The accountant's certificate shall state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein.

(i) *Accountant's certificate; exceptions.* Any matters to which the accountant takes exception shall be clearly identified; the exception thereto shall be specifically and clearly stated; and, to the extent practicable, the effect of each such exception on the related item of the report shall be given.

(j)(1) If a broker or dealer holding any membership interest in and subject to the capital rules of a national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b)(2) thereof ceases to be a member in good standing of such exchange, such broker or dealer shall, within two business days after such event, file with the Commission, as of the date of such event:

(i) A proof of money balances of all ledger accounts in the form of a trial balance;

(ii) A computation of aggregate indebtedness and net capital made in accordance with § 240.15c3-1;

(iii) An analysis of the aggregate market value of fully paid securities in customers' security accounts not segregated showing the location of such securities;

(iv) Ledger net credit balances of money borrowed from banks, trust companies, and other financial institutions and from others, which are fully or partially secured by securities carried for the account of any customer, showing, for each

loan, an analysis of the market value of all collateral for such borrowings by source of collateral, stating separately the market value of: (*a*) Securities carried for the accounts of customers, (*b*) securities owned by the broker or dealer or by any general or special partner or any director or officer of such broker or dealer, and (*c*) any other securities, and

(v) The aggregate amount of customers' ledger debit balances.

The report shall be filed at the Commission's principal office in Washington, D. C., and in duplicate original with the Regional Office of the Commission for the region in which the broker or dealer has his or its principal place of business; *Provided, however,* That such report need not be made or filed if the Commission, upon written request or upon its own motion exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement; *Provided further,* That the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

(2) Attached to the report required by subparagraph (1) of this paragraph shall be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the report is true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner, or if a corporation, by the chief executive officer,

or in his absence, by the person authorized to act in his place.

(3) For the purposes of this § 240.17a-5(j), "membership interest" shall include the following: Full membership, allied membership, associated membership, floor privileges, and any other interest that entitles a broker or dealer to the exercise of any privilege on an exchange.

(i) For the purposes of this section and § 240.15c3-1(b)(2), any broker or dealer shall be deemed to have ceased to be a member in good standing of such exchange when he or it has resigned, withdrawn, or been suspended or expelled from a membership interest in such exchange or has directly or through any associated person sold or entered into an agreement for the sale of a membership interest which would on consummation thereof result in the termination of the broker or dealer's membership interest in such exchange.

(4) Whenever any national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b) (2) thereof takes any action which causes any broker or dealer which is a member of such exchange to cease to be a member in good standing of such exchange or when such exchange learns of any action by such member or any other person which causes such broker or dealer to cease to be a member in good standing of such exchange, such exchange shall report such action promptly to the Commission, furnishing information as to the circumstances surrounding the event."

Federal Rules of Civil Procedure

Rule 17(a), as amended Feb. 28, 1966:

"(a) **Real Party in Interest.** Every action shall be prosecuted in the name of the real party in interest. An executor, administrator, guardian, bailee, trustee of an express trust, a party with whom or in whose name a contract has been made for the benefit of another, or a party authorized by statute may sue in his own name without joining with him the party for whose benefit the action is brought; and when a statute of the United States so provides, an action for the use or benefit of another shall be brought in the name of the United States. No action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest; and such ratification, joinder, or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest."

Supreme Court, U. S.
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FEB 16 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

against

EDWARD S. REDINGTON, as Trustee for the liquidation of WEIS SECURITIES, INC. and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENT REDINGTON

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

against

EDWARD S. REDINGTON, as Trustee for the liquidation of WEIS SECURITIES, INC. and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENT REDINGTON

Preliminary Statement

This brief is submitted by respondent Edward S. Redington, Esq. (the "Trustee"), in opposition to the brief of petitioner Touche Ross & Company ("Touche Ross"). The Trustee was appointed in May 1973 by order of the United States District Court for the Southern District of New York to liquidate Weis Securities, Inc. ("Weis") pursuant to the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa *et seq.* ("SIPA" or the "1970 Act").[1]

1. After this action was commenced, the Securities Investor Protection Act was amended in certain respects, Pub. L. No. 95-283, 92 Stat. 249 (1978). Where reference is made to provisions of the Act in existence before the amendments but not afterwards, the act will be called the "1970 Act."

Mr. Redington is one of the two plaintiffs in this action. A separate brief is being submitted by the Trustee's co-plaintiff, the Securities Investor Protection Corporation ("SIPC"). The two plaintiffs have sought to avoid duplication wherever possible.

Additional Statutes Involved

Section 27 of the Exchange Act, Sections 6(a)(1), 6(c)(2)(B) and 6(c)(2)(C) of the 1970 Act, and the relevant portions of the 1970 Act, as amended, Pub. L. No. 95-283, 92 Stat. 249 (1978), are set forth in the appendix at the end of this brief.

Counter-Statement Of The Questions Presented

1. Whether a private right of action based on Section 17 of the Exchange Act and the rules and regulations thereunder may be brought under Section 27 of the Exchange Act on behalf of the "favored wards" of Section 17—the customers of a brokerage house—when a firm of certified public accountants has made loss to customers unavoidable by preparing and certifying false and unduly favorable information about the broker's financial condition and failing to detect fraud in reports relied on by regulatory authorities under Section 17.

2. Whether the trustee of a brokerage house in liquidation under SIPA is a proper plaintiff and real party in interest to bring a Section 17 action for loss to customer property in his capacity as bailee of the separate fund of customer property established by SIPA, a fund of property distinct from the broker's own assets.

Counter-Statement Of The Case

This case involves the question whether Section 17 of the Securities Exchange Act of 1934[2] and the rules and regulations thereunder provide their intended beneficiaries —the customers of a brokerage firm whom Congress wished to encourage to participate in the nation's capital markets —with effective recourse for the easily identifiable customer losses caused by an accounting firm's reckless and grossly negligent failure to comply with Rule 17a-5. In the forced liquidation of Weis—a liquidation made unavoidable by the false representations and failure to detect fraud in the Rule 17a-5 reports certified by Touche Ross—significant sums of customer property have not been available to satisfy customer claims.

If a federal remedy does not exist, there is no assurance that state law provides a remedy that will restore these sums to customers. The petitioner's position in this very litigation has been that the Exchange Act preempts state law and prevents the state courts from even considering breach of duties under Rule 17a-5. Touche Ross has also taken the position that as a matter of law an accountant cannot be liable in the state courts to customers for any of the conduct, even gross negligence and recklessness, alleged in this complaint.

At the same time Touche Ross asks this Court to hold that it can never be liable in the federal courts—even for recklessness and gross negligence in performing Rule 17a-5 audits and failing to detect fraud. This is an extraordinary position. As the accountant fully understands when voluntarily undertaking to perform such an audit, the Rule 17a-5 audit is a cornerstone of the system for protecting

2. 15 U.S.C. §§ 78a *et seq.* (hereinafter the "Exchange Act"). References to the Exchange Act are to the Act as it existed in 1973. The Act underwent immaterial amendments in 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975).

brokerage house customers established by the Exchange Act. The issue before this Court is whether the customers protected by federal law have a meaningful remedy when they have suffered loss because an accountant's gross negligence and recklessness allowed fraud to be perpetrated upon customers and those who regulate brokers for their benefit.

Background Of The Litigation

This case arises on a motion to dismiss the complaint. Touche Ross, a large, national firm of certified public accountants, audited Weis and certified the adequacy of Weis' financial statements under Section 17 of the Exchange Act and the rules and regulations thereunder as at May 26, 1972. The complaint, which, as the Court of Appeals noted, sets forth the elements of the scheme to falsify Weis' financial condition "in great detail" (A193)[3] and the allegations of which must be accepted as true for the purposes of disposing of Touche Ross' motion to dismiss, alleges that the audit was performed in a negligent, grossly negligent and reckless manner.

In fact, the audit was performed so negligently that it failed to detect false, fraudulent and unsupportable entries in Weis' books and records; failed to discover or alert regulatory authorities to the existence of crude but substantial overstatements of Weis' profitability and net worth; and failed to discern, let alone disclose, misstatements of Weis' net capital ratio. Touche Ross gave the documents filed by Weis with regulatory authorities a clean, unqualified certificate. Yet less than one year after the audit was completed, Weis had to undergo a forced, bankruptcy-type liquidation. This liquidation, the largest ever conducted under SIPA and the only one to date involving

3. References to "A " are to pages of the Appendix submitted with petitioner's brief.

a New York Stock Exchange member firm, was necessary because of the sudden revelation of a precarious, deteriorating financial condition which had existed at Weis since 1972 and because no reliance could be placed on any of Weis' recent books of account, records or financial statements, including those relevant to the protection of customer property and previously certified by Touche Ross.

Requirements Of Section 17 And Rule 17a-5

As a broker-dealer in securities and a member of the New York Stock Exchange, Inc. (the "Exchange"), Weis was subject to regulation for the benefit of customers under the Exchange Act by the Securities and Exchange Commission (the "SEC") and by the Exchange in its capacity as a self-regulatory organization. *See* Exchange Act §§ 6, 19, 15 U.S.C. §§ 78f, 78s.

Among the regulations to which Weis was subject were the statutorily required "net capital" and related financial responsibility rules of the SEC and the Exchange. Exchange Acts §§ 15, 17, 15 U.S.C. §§ 78o,q; SEC Rule 15c3-1, 17 C.F.R. § 240.15c3-1; NYSE Rule 325. As the Court of Appeals observed, these rules and statutes are part of a statutory scheme designed to ensure that brokers are adequately capitalized and can satisfy customer claims on demand. (A197.)

The whole purpose of this extensive system of financial responsibility statutes and rules and regulatory supervision is to build confidence in the operation of capital markets and to encourage people to invest in securities. People have to deposit property with broker-dealers in order to participate in the securities markets. Congress wished to relieve these people of the burden of having to make sophisticated judgments about a particular broker-dealer's financial well-being and to remove the risks that the particular broker to which a customer entrusted his life's savings followed deceitful

practices or operated with insufficient capital. In this way the average man in the street would be encouraged to become a customer and participate in the nation's capital markets. *See* S. Rep. No. 1455, 73d Cong., 2d Sess. 12-15 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 3 (1934).

The requirements of Section 17 and the rules and regulations thereunder, particularly SEC Rule 17a-5, 17 C.F.R. § 240.17a-5 ("Rule 17a-5") relating to audited financial statements and accountants' certificates, are the cornerstones of the financial responsibility rules. As the Court of Appeals noted:

> "It is the reporting system created by Section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows." (A198.)

Because of the pivotal role played by Rule 17a-5, the Rule has always required accounting firms to make specific representations about the scope of their audits and the nature of their opinions with respect to broker-dealers' statements of financial condition. The Rule is especially specific with respect to those areas of an accounting firm's examination relating to a broker's compliance with rules adopted for the protection of customers.

At the time Touche Ross rendered auditing services for Weis, for example, Rule 17a-5(g)(2) required the accountant to identify in its certificate the items of the report covered by the certificate and required the accounting firm to give a "reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers * * *." The Rule also specifically required the accountant to evaluate, and

report to the regulatory authorities upon, the broker's system of internal accounting control. The Rule not only required the accountant to state "whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances;" it also required him to state "whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case." And lest there be any mistake about the auditor's responsibility, subparagraph (g)(3) concluded with the warning that no authority could be implied for omitting any procedures which would normally be employed by independent accountants in order to make the certifications required by the Rule.

In addition to these duties, subparagraph (i) placed a specific duty on accounting firms such as Touche Ross to flag potential trouble spots by providing: "Any matters to which the accountant takes exception shall be clearly identified; the exception thereto shall be specifically and clearly stated; and to the extent practicable, the effect of each such exception on the related item of the report shall be given."

Touche Ross voluntarily undertook, and was paid, to perform all the accounting and auditing services necessary to certify Weis' "Answers to Financial Questionnaire" and other documents for Weis' fiscal year ended "as at May 26, 1972." After supposedly performing all the necessary services in May, June and July of 1972, Touche Ross signed opinion letters with respect to four different financial documents, including the Answers to Financial Questionnaire required to be audited and certified by Rule 17a-5. (A37, A45, A69, A87.) In the opinion letter with respect to the Answers to Financial Questionnaire, Touche Ross falsely stated that it had performed all the auditing steps prescribed by regulatory authorities. (A45.) Touche Ross also falsely certified without qualification the reliability both of Weis' financial and income statements and of its

internal system of accounting control. (A64-65.) On the latter point, Touche Ross concluded that its "study and evaluation disclosed no conditions that we believe to be material weaknesses." (A65.)

The Touche Ross audit thus gave the Weis financial statements and internal accounting systems the cleanest bill of health: an unqualified opinion. The Touche Ross opinions expressed no hint of an exception or disclaimer, not one syllable of qualification. As noted above, Rule 17a-5 required Touche Ross not only to state its opinion with respect to the Answers to Financial Questionnaire (Rule 17a-5(h)), but also to state "specifically and clearly" any "exception" it had to any of the matters covered in its opinion (Rule 17a-5(i)) and to state specifically whether it had omitted any necessary procedures in the course of its audit. (Rule 17a-5(g)(2)(iii).) The dearth of negative comment in its certificates was thus one of the most significant things about the Touche Ross opinions.

Non-Disclosure Of Fraud In The Documents Certified By Touche Ross

The documents certified by Touche Ross were filed with regulatory authorities, and summaries of financial condition based upon them were distributed to customers. Despite the representations in the Touche Ross opinions, the reports audited and certified by Touche Ross "as at May 26, 1972" proved in fact to be materially false and misleading in many respects. Far from being subject to an adequate system of internal control, the Weis records had been manipulated through a crude and easily detectable series of accounting entries by a cadre of five Weis officers and financial personnel to disguise substantial operating losses and an unsatisfactory and rapidly deteriorating net capital ratio and financial position. (A7-8, A16-19.) For example, although the income statements certified by

Touche Ross reflected an ostensible pre-tax profit of $1,700,000, Weis had in fact lost at least $1,500,000; every report certified by Touche Ross, including the Answers to Financial Questionnaire, misstated Weis' net worth and net capital position by substantial amounts. (A8, A19-20.)

These false entries, undetected by Touche Ross despite the unqualified representations about the scope of its audit, infected not only the statements dated "as at May 26, 1972" but every report, statement or summary of financial condition thereafter filed with the Exchange and the SEC, distributed to customers and shown to Weis' board of directors. Once given the *imprimatur* of Touche Ross, Weis' system of internal control continued to be manipulated to disguise from regulatory authorities as well as Weis' board of directors and customers Weis' deteriorating financial position and net capital problems throughout the rest of 1972 and early 1973. (A8-9.)

Finally, after learning through confessions of a conscience-stricken member of the Weis five in May of 1973 of the fraudulent disguising of Weis' true financial condition and the lack of reliability of any of its records,[4] the

4. The story of the events immediately preceding Weis' liquidation is set forth in the Trustee's report to the Bankruptcy Court, of which petitioner asks the Court to take judicial notice. (T.R. Br. at 83 n.47.)

Touche Ross notes (T.R. Br. at 10 n.7) that the SEC, in its action for injunctive relief against Weis and some of its officers, did not also allege securities acts violations against Touche Ross, and that the subsequent criminal indictments filed against the Weis five asserted that these employees had deceived Touche Ross about the falsification of Weis' books and records. The SEC's complaint, however, did not follow a substantial period of investigation, and instituting an injunctive proceeding against Touche Ross on May 24, 1973 would have been a meaningless distraction which would have had no effect on protecting Weis' customers. Similarly, the United States attorney who secured indictments against the Weis five was concerned with painting their criminal conspiracy in the most nefarious colors, not in passing judgment on the adequacy of Touche Ross' auditing procedures or its civil responsibility. The Trustee has never contended that Touche Ross should be held

SEC sought to enjoin Weis and its officers from further violating the Exchange Act; at the same time SIPC sought a decree declaring Weis' customers in need of protection under the 1970 Act. On May 30, 1973, Weis' liquidation was ordered and the Trustee appointed. (A9-10.)

The Weis Liquidation And The Filing Of The Federal Action

The liquidation of Weis under SIPA is a bankruptcy-type proceeding. In addition to satisfying general creditors' claims out of the general property of the debtor, as in a normal bankruptcy, the Trustee in a SIPA liquidation has special duties to marshal and distribute to customers (including SIPC, as statutory subrogee of customers whose claims have been satisfied with SIPC cash advances) a separate fund composed of customer property entrusted to the debtor in a purely custodial capacity by its customers. Because of the delay in the exposure of Weis' financial condition, customer property in the Weis liquidation has been insufficient by several million dollars[5] to satisfy customer claims. In April of 1976, the Trustee and SIPC commenced this action in federal court under Sections 17 and 27 of the

criminally responsible for the Weis *debacle*, only that it should respond in damages for palpable violations of Rule 17a-5 and the standard of care expected of certified public accountants. It is because regulatory authorities cannot evaluate the auditor's performance without conducting prolonged and almost inevitably untimely investigations of their own that private damage actions are an indispensable supplement to SEC and Exchange enforcement activities.

5. At the time the complaints were filed, the deficit in the fund of customer property amounted to some seventeen or eighteen million dollars, fourteen million of which would ultimately be returnable to SIPC as subrogee, the rest to customers with claims against the fund of customer property which exceeded the statutory limits for SIPC cash advances. Subsequent marshalling of assets and recoveries in other litigations by the Trustee have reduced by approximately one-third the amount of the fund deficit that will be sought on behalf of customers at the time of trial.

Exchange Act to recover this deficit in the fund of customer property as well as to recover general damages sustained by Weis as a corporate entity. The filing of the action was preceded by a lengthy investigation by the Trustee under Sections 21a and 167 of the Bankruptcy Act (11 U.S.C. §§ 44a, 567) which included subpoenaing and reviewing the work papers prepared by Touche Ross in its 1972 audit.

The Federal Action

In a common section of the complaint, both plaintiffs allege that Touche Ross assumed specific duties and obligations under Section 17 and Rule 17a-5 when it accepted the engagement to be Weis' auditor and undertook to perform all necessary auditing and accounting services required to certify Weis' Answers to Financial Questionnaire and related documents. The complaint alleges not only that Touche Ross was negligent, grossly negligent and reckless in performing these duties and failing to detect fraud, but also that it falsely certified that it had performed all appropriate services and falsely represented that it could give opinions—for which it had no basis in fact—about the Answers to Financial Questionnaire, report on internal control and other documents dated as at May 26, 1972. (A7-21.)

The Trustee's section of the complaint sets forth six claims for relief. (A21-24.) One of these claims is based on Section 17, and the jurisdiction of the federal court is invoked under Section 27. (A6, A21-22.) Five other claims are based on state law concepts of negligence, breach of contract, and the like. (A22-24.) Jurisdiction over the five other claims is based on pendent jurisdiction and various jurisdictional provisions of the Bankruptcy Act and SIPA. (A6.)

The Trustee's Section 17 claim alleges that Touche Ross violated Section 17 itself, by performing its duties under

Rule 17a-5 negligently and recklessly, and also that Touche Ross aided and abetted Section 17 violations by the five miscreant Weis employees. (A21-22.) The damages claimed in the Trustee's section of the complaint include both the amount necessary to satisfy the deficit in the fund of customer property and the amount of general damages suffered by Weis as a corporate entity. (A22.) The Court of Appeals has held, however, that only the amount necessary to restore the fund of customer property—not damage suffered by Weis as a corporate entity—may be recovered under Section 17 (A202-04), and the Trustee has not sought review of this ruling. Thus the Trustee's Section 17 claims are asserted solely in his capacity as bailee and are asserted on behalf of customers, not Weis.

SIPC, in a separate section of the complaint, alleges eight claims for relief, one of which is also based on Section 17 of the Exchange Act. (A24-31.) SIPC seeks to recover directly, as subrogee of customers, some of the same damages claimed by the Trustee for the purpose of replenishing the fund of customer property. Since the Court of Appeals held that SIPC was an appropriate party to recover these amounts, the Trustee's claims are currently limited to that part of the fund deficit representing claims of customers which remain unsatisfied through SIPC cash advances. (A201-02.) If SIPC were determined to have no right to sue directly in its own behalf, the Trustee, as bailee of the fund of customer property, would be an appropriate plaintiff to sue for the damages claimed by SIPC. As between the Trustee and SIPC, it is of no importance which entity recovers this amount.

The State Court Action

Approximately one year before the filing of their federal action, SIPC and the Trustee commenced a parallel but less comprehensive action in the state court. The state court

action was commenced at that time as a precautionary measure, to guard against any possible running of a state statute of limitations. The state court action was "commenced" before the federal action only in a very technical sense: a summons without complaint was served as permitted in the New York State courts. (A121-22.) Thereafter nothing happened for nearly a year. The complaint in the state court action was actually served and filed after the commencement of the federal action. (A5, A123.) Limited discovery and motion practice have been conducted in the state court action but, as noted by the Court of Appeals (A195 n.7), proceedings in that court have been held largely in abeyance by agreement of the parties pending resolution of the jurisdictional issues in the more comprehensive federal action.

Touche Ross argues that the state court action is virtually identical to this one. (T.R. Br. at 6.) However, while the factual allegations of the two complaints are nearly verbatim, the state court action is dissimilar in one crucial respect: no claim for a direct violation of Rule 17a-5 is made by either plaintiff in the state court because Section 27 of the Exchange Act (15 U.S.C. § 78aa) makes the jurisdiction of the federal courts exclusive in such matters. This difference is important because (a) it affects the ability of either plaintiff to sue directly for violations of the duties imposed by Rule 17a-5 (as opposed to suing for violations of a state law duty of reasonable care based on considerations other than Rule 17a-5) and (b) because it affects the ability of either plaintiff to sue directly for the harm caused to the fund of customer property (as opposed to suing for harm done to Weis as a corporate entity).

State law provides no guarantee that effective remedies for customers exist for Section 17 violations. This point is illustrated by positions taken by Touche Ross in motions to dismiss totalling hundreds of pages which it has served

on SIPC and the Trustee in both the District Court in this action and in the state court action.[6] These positions belie the arguments about appropriateness of state court remedies which Touche Ross has made in this Court. In those motions Touche Ross made the following arguments:

> 1. SIPC has no standing to sue, whether on its own behalf or as subrogee of customers, based on the allegations made in its part of the complaint (Memorandum of Defendant Touche Ross & Co. in Support of Motion to Dismiss and for Related Relief, filed with the district court on September 22, 1976, at 128-40, 152-55);
>
> 2. Customers and those who represent them cannot sue accountants for negligence, gross negligence or anything less than willful misconduct under New York law; fraud would have to be alleged before customers who are not in privity of contract with accountants could even arguably state a cause of action under New York law (*id.* at 142-52); and
>
> 3. Violations of duties assumed by accountants under Rule 17a-5 cannot be considered under the law of any state because Section 27 of the Exchange Act provides that the federal courts have exclusive jurisdiction over proceedings to enforce duties and obligations created by that Rule. (*Id.* at 114-20.)

Touche Ross does appear to concede that state courts might theoretically permit some relief to the Trustee in negligence, but any relief that might be afforded to him would be afforded solely on behalf of Weis as the corporate entity actually in privity of contract with Touche Ross, not

6. The motion in the state court action was subsequently withdrawn without prejudice to its renewal as part of a series of stipulations deferring almost all activity in the state court until the question of jurisdiction was resolved in the federal courts. The District Court never reached these issues because of its decision on Section 17 and the other jurisdictional issues.

on behalf of Weis' customers.[7] Thus when Touche Ross argues in this Court that state law remedies are "adequate" or "appropriate," what it means is that state law remedies are appropriate as far as Touche Ross is concerned because they afford virtually complete immunity to accountants against customers' claims—not because they hold out any hope of protection for customers. The accountant's real "bottom line" in the state courts is that an accountant can *never* be held liable to customers or their representatives for violations of duties assumed under Rule 17a-5.

The Opinions Below

The District Court (Wyatt, J.) dismissed the complaint in the federal action, holding without reference to the actual content of Rule 17a-5 that "Section 17 was designed to supply administrative guidance in the bookkeeping area and not to create any rights in anybody" (A177), and that neither the Trustee nor SIPC was "meant to be protected" by that statute. (A183.) The Court also rejected the Trustee's alternative jurisdictional arguments based on various provisions of SIPA and the Bankruptcy Act. (A184-86.) The Court dismissed all the pendent state law claims without reaching Touche Ross' arguments that most of those claims were not viable as a matter of state law.

The Court of Appeals reversed on the Section 17 questions in a 2-to-1 opinion. After carefully considering the opinion of the district court and the prior decisions of this Court, Judge Lumbard, writing for the majority, held that a private right of action exists under Section 17 and that the two plaintiffs could sue to restore the fund of customer property.

7. Even here, the accountants have made it clear that they will argue that the Trustee's rights should be diminished or defeated by the conduct of the Weis five—conduct having nothing to do with the equities of Weis' customers.

Focusing on the language of Section 17, the duties imposed on accountants under that section and Rule 17a-5 and the role played by accountants in the regulation of brokers, the Court of Appeals reasoned that Weis' customers were members of a class of persons protected by Section 17 and that implying a private right of action on their behalf was "an essential supplement to the scheme of enforcement of Section 17." (A200.)

The court rejected the notion that Section 18 of the Exchange Act—a section creating rights in investors who trade in a particular issuer's stock—provided an exclusive remedy for violations of Section 17, a provision designed to protect investors in a completely different capacity, as customers of a brokerage firm:

> "Since any misstatement in a Section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customer, a strict application of Section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of Section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection." (A200.)

The court below also rejected the notion that an injury resulting from accountant's violation of Rule 17a-5 should be relegated exclusively to the vagaries of state law:

> "Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' customers varies widely. There is no reason to believe that the remedy sought herein is one traditionally relegated to state law." (A200.)

The court below held that the Trustee could not sue under Section 17 on behalf of Weis for harm done to it as a corporate entity, but that the Trustee did have capacity to sue and was the real party in interest under Section 17 in his capacity as bailee of the fund of customer property entrusted to Weis by its customers. (A202-04.) The court below also sustained SIPC's capacity to sue directly as subrogee to the extent it has made cash advances to customers for which it has not been reimbursed from the fund. (A201-02.)

Although Touche Ross argues that the type of *scienter* that must be alleged to recover under Section 17 is a question before this Court, the Court of Appeals specifically left this issue for consideration by the District Court on remand. (A204.) The court also remanded for consideration by the District Court questions relating to pendent jurisdiction over non-Section 17 claims and Touche Ross' argument that the federal action should be stayed in favor of the less comprehensive state court action. (A204.)[8]

Touche Ross' petitions for rehearing and suggestion for rehearing *en banc* were both denied by the Second Circuit. (A227-28.) In the certiorari petition that followed in this Court, Touche Ross did not address the *scienter* question even in a footnote.

Summary of Argument

I.

Customers are the persons for whose "especial benefit" Section 17, Rule 17a-5 and an entire system of broker-dealer regulation were created by the Congress. These provisions

8. The Court of Appeals stated that its decision sustaining federal jurisdiction over the Trustee's Section 17 claim made it unnecessary to consider the Trustee's position regarding the District Court's bankruptcy court jurisdiction over these other claims. (A192n.3.) As set forth in the Trustee's cross-petition for certiorari, filed September 27, 1978, and still *sub judice*, that position amply supports federal jurisdiction over this case.

of law were designed to encourage investment by building investor confidence in the operation of capital markets. Other provisions of the Exchange Act are designed to ensure that investors receive accurate information about the financial condition of companies whose securities they purchase; Section 17 and the financial responsibility rules serve a different purpose: encouraging investors to entrust cash and securities to brokerage firms—the middlemen with whom the investor must deal in order to participate in the nation's capital markets. Section 17 is not unique in this regard. Section 6 of the Exchange Act is another provision intended to ensure proper operation of capital markets by imposing upon national securities exchanges the duty to regulate conduct of member brokerage firms. In a long line of cases beginning with the decision of Judges Swan, Augustus Hand and Clark in *Baird* v. *Franklin,* 141 F.2d 238 (2d Cir.), *cert. denied,* 323 U.S. 737 (1944), the federal courts have recognized that private actions by customers against stock exchanges for violation of their Section 6 responsibilities are essential to the underlying purposes of the Exchange Act. The same logic compels recognition of a private action against accountants in this case.

Accountants play a central role in the regulatory scheme of Section 17, designed to ensure the safety of property entrusted to broker-dealers by customers. Unless regulatory authorities are to hire, train and supervise legions of their own auditors, accurate periodic audits by independent accountants must be relied on as the keystone of the entire regulatory structure. Regulatory authorities cannot and should not audit the auditors to avert financial disasters in advance; they can and should be able to take the auditors' certificate under Rule 17a-5 at face value in conducting their own monitoring of the broker. If the accounting firm fails to detect and alert regulatory authorities to the existence

of fraud, grave problems affecting customers will not be discovered, let alone acted upon, until disaster has become irreversible. Although sanctions can be imposed upon such grossly negligent accountants in the wake of a brokerage firm insolvency, such punitive measures will offer no compensation to investors who entrusted cash and securities to the brokerage firm and found that there were insufficient assets when disaster was discovered. Thus, as the court below correctly recognized, a private action to recover customer losses that might have been avoided by a proper audit is essential to promote the confidence of investors that they may participate in capital markets through broker-dealers.

The enforcement of accountants' obligations in the regulatory structure created pursuant to Section 17 cannot be left to state law. Touche Ross has itself argued below and in the related state litigation that customers and those representing them cannot recover for losses caused by the gross negligence of accountants because customers are not in privity with the auditors. Touche Ross has also argued that the exclusive jurisdiction provision of Section 27 prevents violations of Rule 17a-5 duties from even being considered in evaluating Touche Ross' conduct under state law. But even if all these obstacles to making customers whole in the state courts could somehow be surmounted in this case, the need for a federal remedy would still remain. The protection of customers for losses in a brokerage firm liquidation should not turn on whether state law happens to be liberal or conservative with respect to areas of the law such as malpractice.

A convincing expression of Congress' intent is Section 27 of the Exchange Act, a provision giving the federal courts exclusive jurisdiction over "suits in equity and actions at law" to enforce duties created by Exchange Act rules. As this Court stated in *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), Section 27 provides ample warrant for

recognition of private rights of action which, like this one, are consonant with the specific goals of specific sections of the Exchange Act. In withdrawing actions to enforce provisions such as Rule 17a-5 from the state courts and the vagaries of state law and state procedure, Congress made it imperative to recognize federal rights of action for customers who would otherwise have no remedy at all. As the Court below noted, it would be imputing a Pickwickian logic to the Congress to suppose that it "simultaneously sought to protect a class and deprived the class of the means of protection." (A200.)

II.

A.

Touche Ross virtually concedes in its brief that under the principles applied by this Court in cases like *J. I. Case Co.* v. *Borak, supra, Texas & Pacific Ry.* v. *Rigsby,* 241 U.S. 33 (1916) and *Cort* v. *Ash,* 422 U.S. 66 (1975), the decision below permitting a private right of action by the Trustee and by SIPC must be affirmed. But Touche Ross believes that the foregoing analysis under Section 17 must be discarded because an adjacent section of the Exchange Act, Section 18, gives purchasers and sellers of securities a private right of action for false statements contained in "reports" filed pursuant to the Act or rules and regulations thereunder. Touche Ross contends that Section 18 furnishes the exclusive remedy for injuries caused by false statements in any accountant's "report" pursuant to Rule 17a-5.

The fortuitous juxtaposition of these two statutes, and their common use of the common word "reports," is no meaningful indicium of Congressional intent. Section 18 is concerned with investors not in their role as *customers* of a brokerage firm, but in their role as *traders* in the stock of issuing companies. Like certain other Exchange Act provisions, Section 18 is designed to assure that investors in a company receive accurate information relevant to their

trading decisions. Because Section 18 is not addressed to investors in their capacity as customers of a broker-dealer, it does not evidence any intent to withhold a damage remedy from customers when necessary to redress violations of other provisions of law designed to assure the solvency and proper operations of the middlemen of capital markets. Touche Ross' argument that Section 18 is exclusive, without regard to the different purposes served by various sections of the Exchange Act, is inconsistent with this Court's prior decisions. The Court has already found that private rights of action are available for violations of Section 10b and Section 14a of the Exchange Act. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975); *J. I. Case Co.* v. *Borak, supra.* These holdings cannot be reconciled with the argument that Section 18 is exclusive. In *Piper* v. *Chris-Craft Industries, Inc.* 430 U.S. 1 (1977), this Court held that an unsuccessful tender offeror could not maintain a private damage suit for false statements in a registration statement—which was also a "document filed pursuant to this title" as described by Section 18—not because of any "exclusivity" of Section 18 but because an analysis of the statute and legislative history showed that Congress intended to protect target company shareholders, not unsuccessful offerors.

Far different considerations led this Court to invoke the *expressio unius* principle in *SIPC* v. *Barbour,* 421 U.S. 412 (1975), and *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974), the cases most directly relied upon by Touche Ross. In those cases government intervention had been entrusted exclusively to the discretion of supervised, public entities which were expected to balance competing interests in reaching regulatory decisions. Here, by contrast, the obligations of accountants are prescribed by rule and statute. It is the business of courts to determine whether persons have measured up to their duties.

B.

Recognition of a private right of action on behalf of these two plaintiffs under Section 17 will not produce any of the "imaginary evils" that Touche Ross has conjured up. *Cf. United States* v. *Lee,* 106 U.S. 196, 217 (1882). The federal courts will not be inundated with litigation. The kinds of customer losses for which the Trustee and SIPC seek recovery will occur only in the case of large brokerage firm insolvencies, of which there have been very few. Indeed, Weis represents the only SIPC liquidation of a NYSE member firm.

The concerns that led this Court in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* to recognize the continued validity of a purchaser-seller rule in 10b-5 actions are also not presented by this case. Recognition of the private right of action brought by SIPC and the SIPA Trustee will not lead to " 'liability in a indeterminate amount for an indeterminate time to an indeterminate class.' " *Blue Chip Stamps, supra,* 421 U.S. at 748, *quoting Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931). There are only two plaintiffs here, and the damages they seek under Section 17 are determinate: the value of the customer property that had been entrusted to Weis by its customers but was not in the hands of Weis at the time of liquidation. Liability can be calculated to the penny from the records of the Bankruptcy Court. A Pandora's box of problems of proof will not be opened if a private right of action is recognized on behalf of these two plaintiffs. *Compare* 421 U.S. at 743. There will be no unleashing of the winds of vexatious litigation; a government corporation and a SIPA Trustee subject to supervision by the Bankruptcy Court are not going to bring suits for their "nuisance value". *Compare* 421 U.S. at 740-41. This suit was brought only after the Trustee, acting with the subpoena power of the Bankruptcy Court, had conducted a lengthy investigation of Weis' affairs and Touche Ross' work papers.

Touche Ross raises the specter that if the Trustee and SIPC are permitted to sue, then customers will sue seeking

consequential and incidental damages other than loss of the value of property in their brokerage firm accounts. No such claims are before the Court in this case. No such claims are likely to come before the courts in the future. Incidental and consequential damage claims can arise only when there is a brokerage firm liquidation and customer accounts cannot be salvaged or customers made whole from SIPC advances and fund properties. Recent amendments to SIPA have expanded the limits of advances SIPC is authorized to make to each customer and have given SIPA Trustees increased powers to deliver promptly to customers their accounts in the exact form that they existed prior to liquidation. In any event, if customer suits and speculative damage claims similar to those which concerned the Court in *Blue Chip Stamps* are presented in future cases, these difficulties may be remedied as in *Blue Chip Stamps,* by limiting the damages that may be claimed or limiting suits to SIPC and Trustees. In short, such difficulties can be met by discriminating judicial doctrine, not by wholesale denial of any opportunity for compensation, as Touche Ross urges.

Finally, there is no merit to Touche Ross' argument that allowing a private action to be maintained against it will make accountants, rather than SIPC, the "insurer" of brokerage firm performance. SIPC was established to deal with brokerage firm insolvency dislocations not addressed by other statutes, not to restrict the liability of those that unjustifiably caused those insolvencies. Allowing a private action to be maintained against Touche Ross will not make it the "insurer" of Weis' misfortune, but will only hold it responsible for failures to perform its statutory and regulatory duties.

C.

Touche Ross argues that the Court should decide whether, and to what degree, *scienter* must be established

in order to sustain a Section 17 violation. This issue, however, was not considered by either of the courts below, does not appear to have been fairly comprised within the petition for writ of certiorari, and therefore should not be considered at this time by the Court.

In any event, there is no reason that any conduct more willful than that alleged in the complaint—negligence, gross negligence and recklessness—should be required. Even under an anti-fraud provision such as Rule 10b-5 this Court has recognized that recklessness might be sufficient to establish Exchange Act liability. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 193-94 n.12 (1976). Rule 17a-5, unlike Rule 10b-5, is not an anti-fraud provision. It does not speak in terms of schemes and artifices to defraud but in terms of prescribed duties and obligations which accountants certify that they have performed. An inexcusably lax or grossly negligent accountant can be as destructive to customer property as a reckless or dishonest one, and should be held accountable to customers.

III.

There can be little doubt that the Trustee is a proper plaintiff and real party in interest to sue in his capacity as bailee of customer property. The fund of customer property administered by the Trustee under SIPA consists of property entrusted to the debtor by customers in a custodial capacity and is not considered part of the general assets of the debtor as are, for example, funds or property loaned to a brokerage house by its creditors. Weis as a going concern, and the Trustee after its liquidation, are in a bailor-bailee relationship with customers with respect to this fund of customer property. It is axiomatic that a bailee can sue for harm or loss to the bailed property, holding any recovery in trust for his bailors. That is the only capacity in which the Trustee seeks to pursue his Section 17 claim for relief.

Argument

I.

A PRIVATE RIGHT OF ACTION UNDER SECTIONS 17 AND 27 OF THE EXCHANGE ACT IS NECESSARY TO PROTECT CUSTOMERS FOR LOSSES THAT CANNOT BE PREVENTED WHEN AN ACCOUNTANT DOES NOT COMPLY WITH RULE 17a-5.

A. Accountants Performing Rule 17a-5 Audits Assume Important Duties For The Benefit Of Customers Which Are Enforceable In "Actions At Law" Under Section 27.

Section 27 of the Exchange Act, 15 U.S.C. § 78aa, provides for exclusive jurisdiction in the federal courts over "suits in equity and actions at law" brought to enforce the duties or liabilities created by the Act:

> "The district courts of the United States, * * * shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder * * *"

Recognizing the significance of Section 27 to the question whether a private right of action exists under those sections of the Exchange Act not specifically providing for one, this Court in *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 430, 433 (1964), held that a private right of action existed under Section 14(a) of the Exchange Act because it was "clear that private parties have a right under § 27 to bring suit for violation of § 14(a) of the Act" since Section 27 "specifically grants the appropriate District Courts jurisdiction over 'all suits in equity and actions at law brought to enforce any liability or duty created' under the Act." (377 U.S. at 430-31.) *See also SIPC* v. *Barbour,* 421 U.S. 412,

424 (1975). The guiding principle underlying such an application of Section 27 is that it be used to provide appropriate remedies to enforce the duties imposed by other sections of the Act:

> "It is for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded. 'And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done'." (*J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433, *quoting Bell* v. *Hood,* 327 U.S. 678, 684 (1946).)

See also Rondeau v. *Mosinee Paper Corp.,* 422 U.S. 49, 62-63 (1975); *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282, 288 (1940).

This principle was elaborated upon in *Wyandotte Transportation Co.* v. *United States,* 389 U.S. 191, 202, 204 (1967) as follows:

> "Because the interest of the plaintiffs in those cases fell within the class that the statute was intended to protect, and because the harm that had occurred was of the type that the statute was intended to forestall, we held that civil actions were proper. That conclusion was in accordance with a general rule of the law of torts. See Restatement (Second) of Torts § 286. * * *
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> * * *
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> Denial of such a remedy * * * would permit the result, extraordinary in our jurisprudence, of a wrongdoer shifting responsibility for the consequences of his negligence onto his victim. It might in some cases permit the negligent party to benefit from commission of a criminal act. We do not believe that Congress intended to withhold * * * a remedy that ensures the full effectiveness of the Act."

See also Bivens v. *Six Unknown Named Agents of Federal Bureau of Narcotics,* 403 U.S. 388, 392 (1971); *id.* at 402-03 n.4 (Harlan, J., concurring); *Texas & Pacific Ry.* v. *Rigsby,* 241 U.S. 33 (1916).

Rule 17a-5 clearly places duties on accountants who undertake to perform brokerage house audits. The rule addresses directly what an accountant must do and identifies the specific duties that he must certify that he has performed, especially as the audit involves the broker's compliance with the rules regarding segregation of customer property and other customer protection provisions. As set forth in greater detail above (*supra* at 6-8), subparagraphs (g) through (i) of the Rule require not only that the accounting firm certify that it has performed certain specific accounting and auditing procedures with respect to a broker's Answers to Financial Questionnaire, but they also require it to state in its certificate any exceptions or auditing steps that have been omitted. While nothing in Section 17 or Rule 17a-5 may compel an accountant to undertake a Rule 17a-5 audit, the accountant, once he has engaged himself to conduct such an audit, must be deemed to have assumed a duty to do everything that the Rule requires. This Court recognized the duties accepted by accountants under Rule 17a-5 in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 188 n.1 (1976).

As the accountant is well aware, these duties serve an important public purpose in the scheme of customer protection established by Congress in the Exchange Act. Regulatory authorities cannot scrutinize in minute detail the data underlying the figures reported by every brokerage house in the United States to assure themselves of the accuracy of the information used for regulatory purposes. Instead, certified public accountants voluntarily agree, and are paid, to perform this service. If, as here, the accountant files unqualified certificates but has failed to perform the required services that would have detected

false record-keeping and crude but material misstatements of profitability, net worth and net capital ratios, the early warning system created to prevent loss to customers cannot function in time to prevent financial collapse and loss to customer property. It is necessary to protect customers that the accountant respond in damages for the loss that could have been prevented had he performed a minimally acceptable audit.

B. Customers Are An "Especial Class" Protected By Rule 17a-5.

It is beyond dispute that the duties imposed on accountants by Rule 17a-5 were designed to protect the customers of broker-dealers. Section 17 and Rule 17a-5, which was promulgated thereunder, were promulgated "as necessary or appropriate in the public interest or for the protection of investors." Exchange Act § 17, 15 U.S.C. § 78q. The Rule's requirement that a brokerage firm have financial statements appropriately audited by independent accountants has always served as the keystone for the "early warning system" of brokerage firm financial problems and, indeed, of the entire statutory scheme by which the financial condition of brokers and dealers is regulated for the protection of investors. *See e.g., Boruski* v. *SEC,* 340 F.2d 991, 992 (2d Cir.), *cert. denied,* 381 U.S. 943 (1965); Report and Recommendations of the Securities and Exchange Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 24-27, 31 (1971).

Commenting on the requirement of audited financials in *Boruski* v. *SEC, supra,* for example, the Second Circuit stated:

> "The regulations are not shown to be unreasonable; indeed, it is difficult to see how the Commission could carry on its task of protection of the public investor without financial information such as it sought here." (340 F.2d at 922.)

And when the SEC amended Rule 17a-5 in 1957 it explained that the amendment was to:

> "[a]dd another important protective feature to the Commission's continuing program for improving the safeguards afforded to customers of broker-dealer firms * * *. The Commission believes that *it is essential, for the protection of public investors, that the accounts of these broker-dealers who do business with the investing public and handle customer funds and securities be subject to an annual audit by an independent accountant.*" (SEC News Digest (Aug. 8, 1957) at 3.) (Emphasis added.)

The Commission also noted that insofar as the amendments expanded the certification requirements in the Rule they:

> "represented the Commission's considered view that those certification and reporting requirements constituted a valuable regulatory tool *for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.*" (Emphasis added.)

Report and Recommendations of the Securities and Exchange Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 24 (1971).

In passing the Exchange Act, Congress recognized the vulnerable position of the vast majority of customers who must entrust their securities and cash to broker-dealers in order to participate in the securities markets, but who do not possess the sophistication to protect themselves from loss caused by the inadequate capitalization of a broker or dealer. *See* H.R. Rep. No. 1383, 73d Cong., 2d Sess. 3 (1934). The battery of net capital, "financial responsibil-

ity" and customer segregation rules, all of which are mandated by statute and to the functioning of all of which Rule 17a-5 is crucial, is intended to assure that broker-dealers will be able to meet their obligations to customers on demand. *See, e.g.,* E. Weiss, *Registration and Regulation of Brokers and Dealers,* 57-68 (1965); Report and Recommendations of the Securities and Exchange Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 49-122 (1971); Study of the Securities Industry, Hearings Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 92d Cong. 1st Sess., Part 2, 782-89 (1971). The point of these rules is to protect even the most naive customers against loss suffered because of the financial condition of a particular broker. *Cf. Aldrich* v. *Redington, (In re Weis Securities, Inc.),* [1977-78 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 66,884 (2d Cir. 1978), *cert denied sub nom., Grossmann* v. *Redington,* No. 78-746 (Jan. 22, 1979).

It is clearly appropriate to imply a right of action under Section 17 and the rules and regulations thereunder for customers and those who represent their interests—the class of persons "for whose especial benefit the statute was enacted." *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), *quoting Texas & Pacific Ry.* v. *Rigsby,* 241 U.S. 33, 39 (1916); *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432; *see Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 26-35 (1977). Such an action is necessary under Rule 17a-5 because it is the accountant's false certificate that prevents regulators from putting the system for safeguarding customer property into effect in time to avoid loss.

C. A Right of Action On Behalf Of Customers Is Essential To Achieve Section 17's Goals Of Protecting Customers.

As the Court of Appeals concluded, a right of action is indispensable to effective implementation of the purposes

of Section 17 and the entire statutory system of regulating broker-dealers for protection of customers. Such a right of action is also indispensable if customers are to have any effective recourse when accountants fail to perform the duties required by Rule 17a-5. State court remedies are non-existent or inadequate to protect customers, and (as the Weis experience demonstrates) the protection provided by administrative enforcement mechanisms is likely to come too little and too late to prevent loss to customers when the accountants relied on by regulatory authorities fail to perform their Rule 17a-5 duties.

The argument that customers should look to state court remedies for accountants' malpractice is an insufficient answer. Customers are likely to find that they have no such remedies. Exchange Act provisions and rules are no concern of the state courts, and state law regarding accountant's liability is dependent on rules of privity and procedural nuances which have nothing to do with the nature of the brokerage industry and the principles underlying federal regulation of that industry.[9] Even in those states which have retreated somewhat from the application of inflexible privity rules, the extent to which those rules have been relaxed (*i.e.,* to permit liability to specifically identifiable persons but not to a reasonably foreseeable class of persons such as customers)[10] and the theory on

9. For recent cases on state law following the rules of strict privity in *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 174 N.E. 441 (1931), *see, e.g., Stephens Industries, Inc.* v. *Haskins and Sells,* 438 F.2d 357 (10th Cir. 1971) (Colorado law); *Nortek, Inc.* v. *Alexander Grant & Co.,* 532 F.2d 1013 (5th Cir. 1976) (Florida law); *Howard* v. *Dun & Bradstreet, Inc.,* 136 Ga. App. 221, 220 S.E.2d 702 (Ct. App. 1975) (Georgia law); *Investment Corp. of Florida* v. *Buchman,* 208 So. 2d 291 (Fla. Dist. Ct. App. 1968) (Florida law).

10. *E.g., Arizona Title Insurance and Trust Co.* v. *O'Malley Lumber Co.,* 14 Ariz. App. 486, 493, 484 P.2d 639, 646 (Ariz. Ct. App.

which such relaxation has been based (*i.e.*, consideration of case-by-case factors which have no connection with the purposes of Rule 17a-5),[11] provide no confidence that customers of brokerage firms will find adequate protection in the state courts. In fact, if the right to relief in the federal courts were to be denied, the cruellest irony of all would be the exclusive jurisdiction provision contained in Section 27, a provision which Touche Ross has argued deprives customers of any ability to sue in the state courts for an accountant's breach of his Rule 17a-5 duties. (See *supra* at 14.)

That state remedies may be far less adequate than Touche Ross suggests in its brief to this Court is demonstrated by the position Touche Ross has taken on some of these same issues both in the District Court and in the state court action. Touche Ross' position in both courts has been that customers can state no claim for relief against Touche Ross under state law and that the Trustee can state a state law claim for relief only for negligence (and then only on behalf of Weis and not on behalf of Weis' customers). Touche Ross has also argued in both those courts that no claim can be stated under state law on any theory based on Touche Ross' failure to comply with Rule 17a-5. Thus, if no private right of action is implied for an accountant's failure to comply with Rule 17a-5, customers or their representatives in New York, and in many other states, may well find themselves without an effective remedy for losses incurred because of grossly defective accounting services.

1971); *Security National Bank* v. *Lish*, 311 A.2d 833 (D.C. 1973); *Ryan* v. *Kanne*, 170 N.W.2d 395, 403 (Iowa 1969); *Craig* v. *Everett M. Brooks Co.*, 351 Mass. 497, 501, 222 N.E.2d 752, 755 (Mass. 1967).

11. *E.g.*, *Aluma Kraft Manufacturing Co.* v. *Elmer Fox & Co.*, 493 S.W.2d 378, 383 (Mo. Ct. App. 1973); *Biakanja* v. *Irving*, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (Cal. 1958).

Moreover, the protection afforded customers in this regulated industry should not depend on whether a customer or his broker happens to reside in a state which is liberal or restrictive on matters of malpractice and negligence liability. Congress gave the federal district courts exclusive jurisdiction in Section 27 to eliminate the elements of doubt, uncertainty and randomness which would necessarily exist if enforcement of Exchange Act rules were left to the state courts. *Compare J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 435, *with Cort* v. *Ash, supra,* 422 U.S. at 84-85. *See also Bivens* v. *Six Unknown Named Agents of Federal Bureau of Narcotics, supra,* 403 U.S. at 394-95.

Asking customers to rely on administrative enforcement is also no answer. As the Second Circuit found, a private action on behalf of customers is an "essential supplement" to the enforcement activities of the regulatory authorities. (A200.) The limited efficacy of administrative enforcement in securing Section 17's goals is an important reason for implying a private right of action for violations of Rule 17a-5. *See, e.g., J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432; *Allen* v. *State Board of Elections,* 393 U.S. 544, 556-57 (1969).

Audited financial reports under Rule 17a-5 have always been essential to ensuring customer protection. This is because accurate, audited year-end reports under the Rule provide the benchmark for all subsequent monitoring by the SEC, the Exchange and SIPC. As the Second Circuit pointed out (A199-200), the entire administrative enforcement and monitoring machinery falls apart when independent auditors fail to expose material weaknesses in a broker's financial condition. In its opinion the Second Circuit noted (A199 n.12) that because over 5,000 brokers and dealers are registered with the Commission, the Commission can examine independently the data set out in the

financial statements of only a small fraction of the nation's brokers and dealers. Auditors are engaged to make Rule 17a-5 audits because the SEC could not make this many detailed examinations itself without hiring an army of eye-shaded bureaucrats at intolerable social cost and staggering public expense.

In passing on an almost identical situation in *Borak* this Court expressed the relevant considerations:

> "Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements. The Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited. Time does not permit an independent examination of the facts set out in the proxy material and this results in the Commission's acceptance of the representations contained therein at their face value, unless contrary to other material on file with it. Indeed, on the allegations of respondent's complaint, the proxy material failed to disclose alleged unlawful market manipulation of the stock of ATC, and this unlawful manipulation would not have been apparent to the Commission until after the merger." (377 U.S. at 432-33.)

The theoretical availability of SEC injunctive actions, or of criminal proceedings, for violations of Rule 17a-5 falls short of securing the "protection of investors" for the same reasons identified in *Borak*. The instigation of these proceedings is dependent upon the receipt of warnings from independent accountants. The SEC and the stock exchanges cannot retrace the auditor's steps, and even if they could, weeks and months might pass before

crucial omissions were unearthed. When accountants fail to act, seldom, if ever, can action be taken in time to prevent harm to customer property. The Court below recognized that subsequent criminal convictions (such as those of the Weis five) cannot adequately protect customers. (A199-200.) Convictions punish some of the guilty and injunctions provide some protection for the future investors. But these steps provide no relief for the losses incurred to customers' property in the past because of the accountants' failure to conform to Rule 17a-5.

D. The Decisions Under Section 6 Of The Exchange Act, As Well As This Court's Decision In *Borak*, Support A Right Of Action Under Section 17.

The existence of a private right of action under Section 17 is also supported by the policies which for thirty-five years have supported a right of action for customers against securities exchanges under Section 6 of the Exchange Act, and which led this Court to imply a private right of action under Section 14(a) in *Borak*. *See, e.g., Baird* v. *Franklin,* 141 F.2d 238, 244-45 (2d Cir.), *cert. denied,* 323 U.S. 737 (1944); *Lank* v. *New York Stock Exchange,* 548 F.2d 61, 64-66 (2d Cir. 1977); *Arneil* v. *Ramsey,* 550 F.2d 774, 783 (2d Cir. 1977); *Butterman* v. *Walston & Co.,* 387 F.2d 822, 824-25 (7th Cir. 1967), *cert. denied,* 391 U.S. 913 (1968).

A private right of action under Section 6 was first upheld by the Second Circuit in *Baird* v. *Franklin, supra,* on behalf of an investor who alleged that a member firm of the Exchange had unlawfully converted his securities and that his injuries were caused by the Exchange's failure to enforce its rules and take disciplinary action against the firm. The panel which decided the case was a distinguished one, consisting of Judges Swan, Augustus Hand, and then Circuit Judge Clark. The court's rationale in

upholding the right to sue under Section 6 was written by Judge Clark. After identifying the purpose of Section 6(b) as "the protection of investors" (141 F.2d at 244), Judge Clark reasoned, in language that is particularly relevant here, that:

> "If these aims are to be followed by the Act, then, if the investing public is to be completely and effectively protected, § 6(b) must be construed as granting to injured investors individual causes of action to enforce the statutory duties imposed upon the exchanges. The only two sections of the Act which impose express sanctions upon an exchange for violations are §§ 19 and 32, 15 U.S.C.A. §§ 78s, 78ff. The former permits, § 19(a)(1), the withdrawal of the registration of an exchange for a period not to exceed twelve months or the suspension for a similar period of any member or officer, § 19(a)(3); the latter prescribes a fine of not more than $500,000. Neither section, however, can be said to inure at all to the benefit of the defrauded investor, whom the statute professes to protect reasonably effectively and completely. Both are punitive and remedial measures, rather than compensatory; and while they may be of benefit to future investors, they do nothing for those who have already been the victims of overreachings.
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> * * * If § 6(b) here were to be construed as granting no right of action to plaintiffs, the avowed purpose of 'reasonably complete and effective' protection would indeed be a snare and a delusion.
>
> The fact that the statute provides no machinery or procedure by which the individual right of action can proceed is immaterial. It is well established that members of a class for whose protection a statutory duty is created may sue for injuries resulting from its breach and that the common law will supply a remedy if the statute gives none." (141 F.2d at 244-45.)

The principles that permit a broker's customers to sue a stock exchange for failing to fulfill its statutory obligations to monitor and discipline the broker should permit an action in the interest of customers against another third party actor, the accountant, for failing to perform in accordance with the duties it assumes to audit and report under Rule 17a-5. Section 6 and Section 17 are two integral pieces of the same statutory scheme for regulating broker-dealers for the benefit of customers. There is no way of preventing loss to customer property other than compensatory damage actions if the accountants who are paid to perform a key role in the statutory scheme fail to perform that role in accordance with the statute and the rule.

The principles and policies which justify finding a private right of action under Sections 17 and 27 all coalesced in this Court's decision in *Borak*. In that case this Court considered the issue of "whether § 27 of the [Exchange] Act authorizes a federal cause of action for rescission or damages to a corporate stockholder" arising from misleading proxy materials violative of Section 14(a). (377 U.S. at 428.) The Court unanimously concluded that it did, and in so holding emphasized precisely the same considerations which are at play under Section 17: (1) the language of Section 14 which, like Section 17, evinced broad remedial purposes "for the protection of investors," (*id.* at 431-32); (2) the "clear" authorization in Section 27 for private parties to bring suit for violation of Section 14(a) (*id.* at 430-31, 433); (3) the need for private enforcement as a necessary adjunct to action by the SEC because of the Commission's limited oversight capability in the area (*id.* at 432-33); and (4) the fact that state court remedies were inadequate and fraught with unnecessary and often insur-

mountable hurdles to relief. (*Id.* at 434-35.) The Court held that:

> "while this language [of Section 14(a)] makes no special reference to a private right of action, among its chief purposes is 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve that result." (377 U.S. at 432.)

The *Baird* and *Borak* decisions could not be more on point. The analysis in *Borak*, frequently cited with approval by this Court,[12] and the rationale uniformly adopted in the federal courts to imply a private right of action against self-regulatory bodies under Section 6, apply to the rights of customers against accounting firms under Section 17 and Rule 17a-5.

Accountants are or should be aware of their role in the regulatory scheme and of the implicit reliance placed upon their work by customers when they undertake to conduct Rule 17a-5 audits. They must be held responsible under Section 17 when customers are injured by their failure to comply with SEC rules and detect fraud in time to avert a brokerage house collapse.

12. Touche Ross invites (T.R. Br. at 68 n.41) this Court to state "unequivocally" that *Borak's* viability as a precedent has been eroded by subsequent decisions. As noted in the concurring opinion below (A206 & n.1), however, the decision and rationale in *Borak* have consistently been reaffirmed, and its application to situations comparable to that presented by Rule 17a-5 has never been questioned by this Court. *See, e.g., Piper* v. *Chris-Craft, Industries, Inc.*, 430 U.S. 1, 25 (1977); *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 62 (1975); *SIPC* v. *Barbour*, 421 U.S. 412, 423-24 (1975); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Wyandotte Transportation Co.* v. *United States*, 389 U.S. 191, 202 (1967).

II.

THERE ARE NO PERSUASIVE ARGUMENTS AGAINST RECOGNIZING A PRIVATE RIGHT OF ACTION UNDER SECTION 17.

A. Section 18 Is Not Pertinent To Section 17.

The linchpin of the argument against implying a right of action under Section 17 is that Section 18(a) of the Exchange Act provides the exclusive remedy that any class of persons may have for violations of Section 17. (T.R. Br. at 33-40.) This argument is based on bits and pieces of language from various cases in this Court which are asserted to be "controlling". (T.R. Br. at 40-46.) Touche Ross virtually concedes that, if Section 18 is not regarded as an intentional limitation on the right of customers to sue for violations of Section 17, the considerations for implying private rights of action under *Borak, Texas & Pacific Ry.* v. *Rigsby* and *Cort* v. *Ash* would be satisfied.

The position that Section 18 applies to Section 17, in effect, mixes apples and oranges, for those sections address different and separable classes of persons and interests. The purpose of Section 18 is to define the elements of a cause of action for a specific class of persons who are protected by the anti-fraud provisions of the Exchange Act. These persons are investors in their capacity *as traders* in the stock of listed corporations which file reports with the SEC. Section 18 confers rights on those trading in the stock of a particular corporation who have suffered injury because the price of the stock traded was affected by a misleading statement; it provides remedies to investors *as traders* only when they have purchased or sold a particular issuer's securities. Under the *expressio unius* principle, Section 18 prevents investors *as traders* in a particular security from suing other than when they have made a purchase or sale.

Section 17, on the other hand, is directed at protecting a different class of persons and interests. As set forth in greater detail above (*supra* at 5-6, 28-30), it is aimed at protecting customers of broker-dealers; it protects investors not in their capacity as purchasers or sellers of a particular issuer's securities but rather in their capacity *as customers* who must entrust their cash or securities to broker-dealers. Section 17 addresses a class of persons and interests for whom the imposition of a threshold purchaser-seller requirement like that contained in Section 18(a) would be an inappropriate and artificial limitation, having nothing to do with the purposes for which Section 17 and Rule 17a-5 were promulgated.

Investors *as customers* do not purchase or sell a brokerage firm's publicly traded securities in reliance on Rule 17a-5 certifications and the monitoring system of which they are a part; investors *as customers* simply entrust their money and securities to a specific brokerage firm on the congressionally sanctioned assumption that it is adequately capitalized and regulated. As Judge Lumbard noted below (A200), even the most egregious errors committed by an accountant performing a Rule 17a-5 audit would not in any way affect the price of securities traded by a broker's customers. Yet such errors might well lead to loss of the property entrusted to the broker by the customer. Were Section 18 to be applied to define the limits of causes of action for violations of Rule 17a-5, it would lead to the anamolous result that a statute enacted for the express purpose of protecting a particular class of persons in fact provided no protection whatsoever to that class. That sort of intent should not lightly be imputed to the Congress.[13]

13. The Second Circuit noted below (A198) that the legislative history of Section 17 was silent with respect to congressional intent regarding a private right of action. Touche Ross also can point to no explicit consideration of the issue (T.R. Br. at 46-47). In its *amicus* brief, the American Institute of Certified Public Accountants relies on an excerpt from the Congressional Record to support its argument that Congress intended the purchaser-seller limitation of 18(a) to apply to any action involving any reports filed with the SEC. (Amicus Br. at 9-11.) The remarks relied on provide no such support. The focus of those remarks was solely the burden of proof required in cases involving the purchase or sale of securities based on misleading statements. To the extent that some congressional intent on the scope of Section 18(a) may be divined from those remarks, it appears to support the view that Section 18(a) does not apply to Section 17. The rationale for Speaker Rayburn's position that the disseminator of misleading information should be held liable even absent actual knowledge of falsity was that he would be unjustly enriched in the sales transaction with the investor. The remarks directly following those quoted in the *amicus* brief make this clear:

> "Mr. Hollister: Exactly, and it may have been a lawyer or an accountant or any other expert hired for the occasion. We make such a man practically an insurer, no matter how honest he may have been, if the statement is misleading. If he cannot sustain the burden of proof he is going to be held liable.
>
> Mr. Rayburn: Exactly, because he got the other man's money."

78 Cong. Rec. 8040 (1934). *See also id.* at 8039. Such a rationale obviously has no applicability to accountants who make certifications under Rule 17a-5.

Touche Ross' attempt to superimpose Section 18 on Section 17, and its invocation of the *expressio unius est exclusio alterius* doctrine (T.R. Br. at 41-43) and the principle that a right of action should not be implied where a narrower express remedy exists for the same wrong (T.R. Br. at 43-45), consequently miss the mark. It would be an extraordinary result, mandated by no prior decision of this Court, to divine from a provision defining the rights of one class of persons protected by one set of Exchange Act provisions an intent to deny a right of action to a different class of persons—customers of brokerage firms *in their capacity as customers*—protected by different provisions of the Exchange Act. Section 18(a) has never before been read to forbid damage actions under Section 27 by persons

such as customers who are protected by a set of provisions different from those aimed at protecting traders in a particular issuer's security against fraud and misinformation. *See, e.g., J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964); *Gerstle* v. *Gamble-Skogmo, Inc.,* 478 F.2d 1281 (2d Cir. 1973); *Baird* v. *Franklin,* 141 F.2d 238 (2d Cir.), *cert. denied,* 323 U.S. 737 (1944).[14] This Court's decisions under Rule 10b-5 and the Williams Act have never suggested that Section 18 is the exclusive remedy for Exchange Act violations even where, as in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), the filing of a "report" or "document" was involved. See *supra* at 21.

The situations involved in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) (*"Amtrak"*) and *SIPC* v. *Barbour,* 421 U.S. 412 (1975) were not comparable to the Section 17-Section 18 dichotomy in the Exchange Act. *Amtrak* and *Barbour* involved situations where private parties sought to intrude into areas where the right to injunctive or similar relief had been entrusted to a government entity or the attorney general, and where the private party was suing either to force that entity to act or, in effect, to reverse that entity's

14. Touche Ross points to a number of cases which have suggested that Section 18 provides the exclusive remedy for violations of Section 13(a) of the Exchange Act. (T.R. Br. at 51-54.) Section 13(a) requires issuers of securities to file certain required information with the SEC "for the proper protection of investors and to insure fair dealing in the security." Section 13 was designed to protect investors trading in a corporate issuer's securities from misleading statements by the issuer relating to its financial condition. *See* S. Rep. No. 792, 73d Cong., 2d Sess. 11 (1934). As the language and purpose of Section 13 itself make evident, the cases relied upon by Touche Ross cannot assist in the resolution of the issue herein. At best, they stand for nothing more than that the remedy and limits set forth in Section 18 should apply to all members of the same class of investors to which Section 18 itself is addressed—the traders in securities, the price of which may have been affected by the issuer's fraud. Sections 13 and 18 are both integral parts of the Exchange Act's anti-fraud provisions. Section 13 does not concern customers—the class of persons protected by Section 17.

decision. In both cases implying a private right of action on behalf of one member of the class benefited by the statute would have conflicted with the interests of other members of the class and therefore would have contravened the congressional purpose in committing the balancing of interests to the discretion of a public official; in neither case did the statute in question contain a grant of jurisdiction comparable to that in Section 27 of the Exchange Act.

In *Amtrak* a railroad passenger organization brought suit under Section 307 of the Rail Passenger Service Act of 1970, 45 U.S.C. §§ 501 *et seq.,* to enjoin the discontinuance of certain passenger trains by the National Railroad Passenger Corp. (Amtrak). Section 307 narrowly provided for enforcement of the Act's duties by the Attorney General and, solely in the case of labor disputes, by aggrieved employees. (414 U.S. at 456-57.) The Act's purpose was to ensure the expeditious discontinuance by Amtrak of uneconomic railroad routes. Suits for injunctive relief by individuals across the country who felt aggrieved by the abandonment of particular routes would have frustrated the very purpose of the Act and would have been antagonistic to the interests of individuals in other parts of the country. (*Id.* at 463-64.) The Court therefore held that Section 307—the sole jurisdictional provision in the Act—created a right of action only in the parties enumerated therein. (*Id.* at 464-65.) In reaching its conclusion the Court eschewed exclusive reliance on the *expressio unius* doctrine and focused also on the legislative history which it found to be consonant with the limitations set forth in Section 307 (*id.* at 458-62) as well as with its determination that conferring a right of action on private parties with conflicting interests would be incompatible with the "efficient apparatus" set up by the statute to achieve its goals. (*Id.* at 463-64.)

The issue in *Barbour* was whether private parties had a right to compel SIPC to act to initiate liquidation proceedings under the 1970 Act. In denying the existence of such a right this Court focused on the fact that Congress had under the 1970 Act, as under the Amtrak Act, created a supervised corporate entity to solve a public problem (421 U.S. at 420); the Court again emphasized that delegating a right of action to private parties would have been totally at odds with the statutory scheme and purposes. (*Id.* at 421-23.) The Court was especially concerned about the grave risks to brokers (and of course their many other customers) if individual customers, without any attempt to seek less drastic solutions, were permitted to institute actions seeking compulsory liquidation predicated on allegations of the broker's financial insecurity. (*Id.* at 422-23.) For this reason Congress had committed the decision whether to liquidate a broker exclusively to SIPC and the SEC. The Court's distinction of the Exchange Act and its discussion of *Amtrak* is especially instructive here:

> "Unlike the Securities Exchange Act, the SIPA contains no standards of conduct that a private action could help to enforce, and it contains no general grant of jurisdiction to the district courts. As in *Amtrak*, a private right of action under the SIPA would be consistent neither with the legislative intent, nor with the effectuation of the purposes it is intended to serve." (*Id.* at 424.)

This case is clearly distinguishable from *Amtrak* and *Barbour*. No balancing of competing interests or consideration of discretionary factors is involved. This is a straightforward damage action based on violations of specific rules, an action involving issues of a sort which courts and juries are quintessentially well equipped to handle. The existence of such an action would benefit all customers and

thus would clearly effectuate rather than contravene the statutory purposes; indeed, a damage action for the losses to customer property which regulatory authorities are unable to prevent because of a defective audit was found below to be an "essential supplement" to the statutory scheme. (A200.) *See SIPC* v. ***Barbour, supra,*** 421 U.S. at 423-24 (carefully distinguishing *Borak*); 31 Vand. L. Rev. 1513, 1527-28 (1978).

Touche Ross' reliance on *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), is also misconceived. *Blue Chip Stamps* only involved the question whether a particular class of persons—offerees of an allegedly misleading stock offering who neither purchased nor sold any of the offered shares—could sue for damages under Rule 10b-5. The Court held that they could not. The Court never questioned the principle that a private right of action could exist on behalf of the intended beneficiaries of a statute and, indeed, reaffirmed that such an implied right of action existed to enforce Rule 10b-5. (*Id.* at 730.)

In limiting the class of plaintiffs who could sue under 10b-5 in ***Blue Chip Stamps*** the Court relied in part upon what it termed "policy considerations." The Court was concerned that absent enforcement of the purchaser-seller requirement (1) strike suits under 10b-5 would become more prevalent (*id.* at 740), (2) the resolution of litigation would depend too heavily on the unrebuttable and unreliable oral testimony of plaintiffs as to what they would have done rather than on objectively demonstrable evidence (*id.* at 743-47), and (3) there would exist a potentially indeterminate number of plaintiffs whose prospective damage claims would be highly speculative. (*Id.* at 745-48.) Focusing on these considerations, Touche Ross argues (T.R. Br. at 48) that a private right of action should be denied in this case because the Section 17 claims asserted are "exactly the kind of speculative and unreliable claims that *Blue Chip Stamps* held are, and should be, excluded by the purchaser-seller requirement."

Touche Ross' argument plainly overstates the case. While the considerations relied upon by the Court in *Blue Chip Stamps* had relevance to the situation presented there, this action involves plaintiffs and claims at the farthest antipodes from those which troubled this Court in *Blue Chip Stamps*. The plaintiffs here—a court-appointed Trustee and a governmental corporation—are not likely to bring strike suits against accountants in the hope of securing unjustified, *in terrorem* settlements. See also *infra* at 49-50. This action, for example, is not based on speculation. It is based on a lengthy investigation of Weis' demise and Touche Ross' work papers, an investigation conducted with all the tools available to trustees under SIPA and the Bankruptcy Act.

The claims involved in this action are asserted on behalf of a *determinant* number of customers who entrusted a *determinant* amount of property to the debtor, and whose representative is now suing under Section 17 for a *determinant* amount of damages. These claims are based on objective evidence relating to customers' accounts contained in the debtor's books and records and not on potentially unreliable and unrebuttable oral testimony.

The accountants suggest that individual customers may create undesirable complexities by suing for additional or incidental items of damage resulting from delay in return of property or receipt of cash instead of securities in SIPA liquidations. But no such claims are presently before the Court. The recent amendments to SIPA, which are intended to permit all customers' property to be returned to them promptly and intact, make it unlikely that such claims will arise with any frequency in the future. See *infra* at 48-49. In any event it will be occasion enough for the judiciary to consider *Blue Chip Stamps* and the possible restrictions which might be placed on incidental damage

claims when, as and if those claims actually arise. Neither the facts nor the rationale of *Blue Chip Stamps* properly applies to the limited right of action recognized for SIPC and the Trustee by the Court of Appeals.

B. The Miscellaneous Policy Considerations Adverted To By Touche Ross Are Of No Moment.

Touche Ross also raises several policy considerations which it asserts militate against a Section 17 right of action. These considerations are primarily that accountants will become unwilling "insurers" subject to limitless suits by an indeterminate class of persons, and that the federal courts will be overwhelmed by litigation. (T.R. Br. at 71-78.)

Before addressing these assertions in greater detail it must be recognized at the outset that, if policy considerations are relevant to resolving the question of a right of action under Section 17, then the principal policy to be considered is protection of public investors. This is the purpose of the statute and rules. As set forth more fully above, absent private damage enforcement customers will have illusory protection and be subject to divergent, irrelevant and inadequate state rules. In view of the broad grant of jurisdiction in Section 27 for violation of Exchange Act duties, it is appropriate for the federal courts to fashion federal remedies for the protection of those for whose direct benefit the duties are imposed. *E.g., J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433; *Baird* v. *Franklin, supra,* 141 F.2d at 245. *See Rondeau* v. *Mosinee Paper Corp., supra,* 422 U.S. at 62-63.

Contrary to Touche Ross' argument (T.R. Br. at 73) that "the holding of the Court of Appeals majority necessarily is open-ended and has the potential for effecting an extreme expansion of the scope of civil liability under the 1934 Act," the prospective liability of accountants under Section 17

will arise only in exceptional circumstances and will likely be limited to a small group of persons. This is primarily because of recent amendments to the 1970 Act which provide increased levels of protection for customers as well as greater speed and flexibility in satisfying customer claims than existed under the original SIPA. *See* Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249; H.R. Rep. No. 95-746, 95th Cong., 1st Sess. 37, 39-40 (1977).

Under the new SIPA, customer accounts are protected by SIPC for up to $40,000 in cash and up to $100,000 in cash and securities, instead of the $20,000 and $50,000 protection which existed under the 1970 Act. *Compare* 15 U.S.C. §§ 78fff(f)(1), (f)(1)(A), *with* Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 9 (§§ 9(a), 9(a)(1) as amended), 92 Stat. 265. In addition, in order to increase the satisfaction of customer claims by securities instead of cash, and in order to ensure that customer accounts are restored as closely as possible to their positions at the filing date, SIPA trustees now have power to purchase securities for customer accounts and to permit full securities positions to be returned to margin customers and others; and in order to accelerate the distribution of securities to customers and reduce losses caused by delay in return of property, the new SIPA allows the Trustee to transfer to other brokers (who are members of SIPC) all or part of a customer's account. *See* Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 9, (§§ 8(c)(2), 8(d), 8(f) as amended), 92 Stat. 262-63, 265. The purpose and effect of these amendments is to make it extremely unlikely that customers will suffer appreciable loss in a brokerage house collapse and to eliminate to a large extent the kind of miscellaneous damage claims which Touche Ross suggests (T.R. Br. at 76-77) might be asserted against accountants even when customers' claims for cash and securities have been satisfied by the new monetary limits. *See* H.R. Rep. No. 95-746, 95th Cong., 1st Sess. 21-22, 39-42 (1977). Thus, all that is really involved here is the possibility of a small number of damage claims being filed in the future by SIPC, and perhaps in rare cases by a SIPA trustee, in the extraordinary liquidation in which the size of monetary loss to customer property and the nature of the accountant's conduct appear to make such an action worthwhile.

Touche Ross' statistics on broker liquidations and the number of customers who have participated in SIPA proceedings in the eight years since SIPA was enacted (T.R. Br. at 75) also exaggerate what the future is likely to hold in store in terms of potential Section 17 litigation, whether against accountants or others. Only a handful of the liquidations referred to by Touche Ross have occurred since 1973, and the amount of losses sustained by customers or even by SIPC in these post-1973 liquidations has not been substantial. *See* H.R. Rep. No. 95-746, 95th Cong., 1st Sess. 37, 38 (1977). As noted in the Senate Report of the SIPA amendments:

> "There have been 129 liquidation proceedings under SIPA since 1970, the great majority of those liquidations commenced in 1973 and earlier years. Because of better surveillance and other factors, the number of liquidations has been declining since that time." S. Rep. No. 95-763, 95th Cong., 2d Sess. 2 (1978).[15]

15. Under the 1970 Act, the total number of customers whose claims were not satisfied in full (and whose claims could therefore conceivably have led to a Section 17 suit against anyone, either by a SIPA trustee or an individual claimant) in 124 liquidations, including Weis, between 1970 and the first six months of 1977, was 163, and their claims totaled only $3 million. H. R. Rep. No. 95-746, 95th Cong., 1st Sess. 21, 40. The Weis liquidation accounts for a substantial portion of both figures. Had the increased amounts of SIPC cash advances established by the SIPA amendments been in effect, the number of customers with unsatisfied claims would have been reduced to 21, and their claims would have totaled $2 million. *Id.* at 40.

The fear that, regardless of fault, accountants will become scapegoats for breakdowns that occur in the regulatory scheme is unfounded. SIPC and SIPA trustees are the most likely, if not the only, possible plaintiffs under the new SIPA. These entities are accountable to the Congress and the courts respectively and are not going to embark on witch-hunts for accountants. If a Section 17 right of action is sustained, accountants will face liability only in the following exceptional circumstances: first, a major brokerage house must fail and be placed in liquidation; second, the accountant must have breached its obligations under Section 17 to the customers of the brokerage house in a manner so egregious that effective remedial action becomes impossible (for example, as here, where Touche Ross is alleged to have failed to detect crude bookkeeping manipulations and acts of fraud and criminal conduct); and finally, the collapse of the brokerage house must be so complete that even under the new SIPA, customer claims cannot be satisfied from property marshalled in the course of the liquidation. This unhappy conjunction of circumstances is not an everyday event.[16] It is the type of event for participation in which an accountant ought to be held accountable if he is at fault.

16. Weis, for example, is the only member of the New York Stock Exchange ever to be liquidated under the 1970 Act. One hundred twenty-eight SIPA liquidations other than this one have taken place; they have apparently produced no actions under Section 17. The customer actions that Touche Ross points to (T.R. Br. at 16 n.12) are all suits arising out of this liquidation. These circumstances underscore the limited potential liability of accountants under Section 17.

Of course, in those rare instances when accountants do fail to perform their Rule 17a-5 duties and customers suffer compensable damage in a liquidation, Sections 17 and 27 must be available to provide relief.

C. *Scienter* Is Not Required To Sustain A Right Of Action Under Section 17.

Relying on snatches of this Court's decision in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) Touche Ross takes the fall back position that *scienter* must be an element of the Trustee's right of action under Section 17. (T.R. Br. at 80-83.)

The issue of *scienter* was not addressed by either the District Court or the Court of Appeals and should not be considered in the first instance by this Court. Moreover, this question was not fairly comprised, or even suggested, in the questions presented in the petition for certiorari. *Cort* v. *Ash, supra,* 422 U.S. at 72-74 n.6, *quoting Neely* v. *Eby Construction Co.,* 386 U.S. 317, 330 (1967).

If the Court does reach this issue, it would be erroneous to attempt to extrapolate from this Court's decision in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) regarding Section 10b and Rule 10b-5 some sort of *scienter* requirement for Section 17. *Hochfelder* itself recognized that recklessness might be an appropriate standard even under a specific anti-fraud provision such as Rule 10b-5. (425 U.S. at 193-94 n.12.)

Unlike Section 10b and the rules and regulations thereunder, moreover, Section 17 and its rules and regulations are not anti-fraud provisions directed at schemes and artifices to defraud or cunning and manipulative devices. *Compare Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 471-77 (1977); *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 197-201. Section 17a-5 protects customers by imposing certain duties on accountants who undertake to audit a broker in accordance with the requirements of the Rule. An accountant need not have a specific intent to defraud in order to breach his duties under the Rule and impair the efficacy of the system established by Congress for protecting customers. Negligence, gross negligence and recklessness are alleged in the complaint, and any of

these standards of fault should suffice for imposition of Section 17 liability.

III.

THE TRUSTEE IS A REAL PARTY IN INTEREST TO SUE UNDER SECTION 17 FOR DAMAGES TO THE FUND OF CUSTOMER PROPERTY OF WHICH HE IS BAILEE.

The Second Circuit held that the Trustee could maintain this action on behalf of customers whose claims have not been satisfied in full out of the fund of customer property available to the Trustee in the Weis liquidation. (A203-04.) The Trustee was permitted to sue in this limited capacity as bailee of customers' property because of his special duties to marshal and return a fund of customer property separate and apart from Weis' own assets.[17] The Second Circuit's decision on this point was based on centuries-old principles of bailment law, the special duties of SIPA Trustees and the special nature of customer property, and should not be disturbed by this Court.

The key to understanding the Trustee's right to sue on behalf of customers under Section 17 is recognition that the Trustee's Section 17 claims are for damages to a specific and separate fund of customer property, not for damages to Weis as an entity or to any property deemed part of Weis' assets. The Trustee has not sought review of the portion of the Second Circuit's decision which denied him capacity to sue under Section 17 for damage done to the Weis general estate or to Weis as a going concern.

The scheme of remedies provided for customers by Congress in the 1970 Act (and previously in Section 60e of the

17. The Court of Appeals held that SIPC, as subrogee of customers whose claims were satisfied with SIPC cash advances, could sue to recover directly the portion of the deficit in the fund representing SIPC's claim against the fund for unreimbursed cash advances. (A201-02.) If this determination were to be reversed, the Trustee would be a proper plaintiff to sue for this portion of the deficit as well as that portion attributable to unsatisfied individual customer claims.

Bankruptcy Act as well as at present in the recent amendments to the 1970 Act) is predicated on the basic concept that customers never lose ownership of customer property, no matter how it may be registered, hypothecated or commingled in the broker's hands; the broker owes a special duty to safeguard that property (at least in the aggregate) and remain able to return it. The provisions of the 1970 Act, as well as Section 60e and the new SIPA, recognize the rights of customers as a group to the aggregate of customer property even when a specific customer cannot trace to a particular fund of cash or security. *See* Bankruptcy Act Section 60(e)(2), 11 U.S.C. § 96 (e)(2); 1970 Act §§ 6(c)(2)(B) and 6(c)(2)(C), 15 U.S.C. §§ 78fff(c)(2)(B), (c)(2)(C); Securities Investor Protection Act Amendments of 1978, Pub.L.No. 95-283, § 9, (§ 8(c) as amended), § 15, (§§ 16(4), (5) as amended), 92 Stat. 262-63, 272; 3 W. Collier, *Bankruptcy* ¶ 60.71 at 1158 (14th ed. 1976); H.R. Rep. No. 1409, 75th Cong., 1st Sess. 31 (1937).[18]

18. *See also, e.g.,* Section 8-313(2) of the New York Uniform Commercial Code which provides:

> "(2) The purchaser is the owner of a security held for him by his broker * * *. Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk." (McKinney's 1964.)

The basic ownership concepts actually antedate all these legislative enactments. Prior to the 1970 Act and Section 60e of the Bankruptcy Act, when concepts of ownership originally developed for tangible property were applied in somewhat procrustean fashion to intangibles, customers of stockbrokers were considered the owners of stock held in the broker's own name under the majority or "New York" rule. Even in margin transactions, where the metaphysics of title seemed least clear, the customer was considered owner of the stock and the broker was considered but a pledgee—a classic type of bailment relationship. *E.g., Gorman* v. *Littlefield,* 229 U.S. 19 (1913); *Sexton* v. *Kessler & Co.,* 225 U.S. 90 (1912); *Richardson* v. *Shaw,* 209 U.S. 365 (1908); *Content* v. *Banner,* 184 N.Y. 121, 76 N.E. 913 (1906); *Markham* v. *Jaudon,* 41 N.Y. 235, 241 (1869). Under the minority or "Massachusetts" rule, the bankruptcy of the broker was deemed to vest title to the stock held by the broker in the

Under the 1970 Act applicable to the Weis liquidation, this principle of customer ownership was reflected in two categories of customer property—"specifically identifiable property" of cash customers and the "single and separate fund" of "customer property." Specifically identifiable property comprised fully paid for securities in customer name and fully paid for securities in street name allocated to cash customers. 1970 Act § 6(c)(2)(C), 15 U.S.C. § 78fff(c)(2)(C). All other property "at any time received, acquired, or held * * * from or for the account of customers", including securities equal to 140 percent of a margin customer's margin indebtedness to the broker and property commingled by the broker with its own property, was conceived of as part of the single and separate fund of customer property. 1970 Act § 6(c)(2)(B), 15 U.S.C. § 78fff (c)(2)(B).

Under the new SIPA, the equivalent of specifically identifiable property is "customer name securities"—a term defined to mean all securities registered or in the process of being registered in the name of a customer. All other property that was or should have been set aside for customers by the broker is termed simply "customer property". *See* Securities Investor Protection Act Amendments of 1978, Pub.L. No. 95-283, § 15, (§§ 16(4),(5) as amended), 92 Stat. 272.

Under both the new SIPA and the 1970 Act, the same concept obtains: the Trustee administers a fund of "customer property" which cannot be identified in kind but is nevertheless recognized as property owned by customers collectively. This fund of "customer property" is regarded as belonging to customers and not simply as having

customer, who could then obtain possession by paying any debit balance owing. In practice, therefore, the results were substantially the same as under the New York rule. *Leonard* v. *Hunt*, 36 F.2d 13, 15 (1st Cir. 1929). 3 W. Collier, *Bankruptcy* ¶ 60.72 at 1159-60 (14th ed. 1976); Note, *Protection of the Accounts of Stockbrokerage Customers*, 77 Harv. L. Rev. 1290, 1299 (1964).

become part of the broker's general assets in the same manner as, say, property purchased by a broker or cash loaned to it by general creditors.

While the broker is a functioning concern, its stewardship of large amounts of customer property subjects it to strict rules regarding hypothecation and segregation of securities and cash (SEC Rules 15c2-1, 15c3-3, 17 C.F.R. § 240.15c2-1, 15c3-3), and unique net capital rules designed to ensure that the broker will be reasonably able to meet its special obligations as custodian of customer property (SEC Rule 15c3-1, 17 C.F.R. § 240.15c3-1). *See* Guttman, *Broker-Dealer Bankruptcies*, 48 N.Y.U.L. Rev. 887, 893-903 (1973). When the broker is liquidated under the 1970 Act and a SIPA Trustee is appointed, the Trustee is under a duty to marshal both specifically identifiable property and the single and separate fund (or, under the new SIPA, customer name securities and customer property) and return this customer property to customers "as promptly as possible." 1970 Act § 6(a)(1), 15 U.S.C. § 78fff(a)(1); Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 8, (§ 6(a)(1) as amended), 92 Stat. 259. That is the primary purpose of a SIPA liquidation. The Trustee becomes the bailee of the customer property which had been entrusted to the broker by its customers.

As bailee, the Trustee has the right, under well-settled principles of bailment law, to sue third parties such as Touche Ross for any harm to, or diminution of, the fund of customer property caused by the acts or omissions of such third parties. With respect to this property, the Trustee is in a position no different from the owner-bailee of a furniture warehouse suing on behalf of the many owners of the furniture stored there. *See* Adv. Comm. Note to Fed. R. Civ. P. 17(a), 39 F.R.D. 69, 85.

The law is clear that a bailee, being entitled to the possession of the property bailed, has a special interest in

it which is sufficient to entitle him to sue third parties for a loss of or injury to the property:

> "For centuries it has been the settled rule, both at common law and in admiralty, that either the bailor * * * or the bailee * * * might sue the tort-feasor for destruction of the bailed goods." *The W. C. Block*, 71 F.2d 682, 683 (2d Cir.), *cert. denied*, 293 U.S. 579 (1934). (Citations omitted.)

Accord, e.g., The Beaconsfield, 158 U.S. 303, 307 (1895); *Luckenbach Steamship Co.* v. *United States*, 315 F.2d 598, 605 (2d Cir. 1963); *Bradley* v. *St. Louis Terminal Warehouse Co.*, 189 F.2d 818, 823 (8th Cir. 1951); *Rogers* v. *Atlantic, Gulf & Pacific Co.*, 213 N.Y. 246, 258, 107 N.E. 661, 664 (1915).

While it is true, as Touche Ross points out (T.R. Br. 86-91), that a bailee's right to sue is based on his special possessory interest in the property entrusted to him, that interest does not define the extent of the bailee's right to recover but merely reflects that it is his special possessory interest which makes a bailee an appropriate party in interest to prosecute an action for injury to the subject of the bailment. The courts have long recognized the right of bailees to represent and requite the interests of bailors as well as their own possessory interests.[19] In *The Beaconsfield*, 158 U.S. 303, 307 (1895), for example, this Court clearly indicated the representative capacity in which the bailee may sue on behalf of the bailor:

> "The Beaconsfield having been sunk in a collision with the Britannia, her master and owner, as bailees of her cargo, proceeded against the Britannia for damages done to such cargo. This they had a right to do. It is perfectly well settled that the carrier is so far the representative of the owner that he may sue in his own name, either at common law or in admiralty, for a trespass upon or injury to the property carried." (Emphasis added.)

19. In fact, originally the common law developed so that only the bailee—the party in possession—could enforce claims for injury to the bailed property. It was only later that the bailor was also allowed to vindicate his property interests. O. W. Holmes, *The Common Law*, 164 *et seq.* (1881); *Berger* v. *34th Street Garage, Inc.*, 274 App. Div. 414, 417, 84 N.Y.S.2d 348, 351 (1st Dep't 1948), *appeal denied*, 275 App. Div. 660, 86 N.Y.S.2d 667 (1st Dep't 1949).

Accord, Baldwin v. *Hill*, 315 F.2d 738, 742 (6th Cir. 1963) ("While it is true that a bailee does not have title to the bailed chattels, still he has a possessory interest in them. He may recover damages for injury done to the property and has other possessory rights. With respect to third persons, [a bailee] stands in the place of the owner [bailor]"); *Luckenbach Steamship Co.* v. *United States*, 315 F.2d 598, 605 (2d Cir. 1963); *Bradley* v. *St. Louis Terminal Warehouse Co.*, 189 F.2d 818, 823 (8th Cir. 1951).

As the Court of Appeals noted (A203-04), the representative character of the bailee-plaintiff is recognized in Rule 17(a) of the Federal Rules of Civil Procedure approved by this Court.[20] The Rule provides that a bailee or trustee may sue in his own name "without joining with him the party for whose benefit the action is brought." The Committee Note explaining the specific addition in 1966 of bailees to the list of those parties who could bring representative suits clearly recognized the representative capacity in which a bailee sues on behalf of the bailor:

> "The rule adds to the illustrative list of real parties in interest a bailee—meaning, of course, *a*

20. Rule 17(a) reads, in pertinent part, as follows:

> "Every action shall be prosecuted in the name of the real party in interest. An executor, administrator, guardian, *bailee*, trustee of an express trust, a party with whom or in whose name a contract has been made for the benefit of another, or a party authorized by statute may sue in his own name *without joining with him the party for whose benefit the action is brought.* * * *" (Emphasis added.)

> *bailee suing on behalf of the bailor* with respect to the property bailed. (When the possessor of property other than the owner sues for an invasion of the possessory interest he is the real party in interest.) The word "bailee" is added primarily to preserve the admiralty practice whereby the owner of a vessel as bailee of the cargo, or the master of the vessel as bailee of both vessel and cargo, sues for damage to either property interest or both. But there is no reason to limit such a provision to maritime situations. The owner of a warehouse in which household furniture is stored is equally entitled to sue on behalf of the numerous owners of the furniture stored." (Emphasis added.) 39 F.R.D. at 84-85.

The premise of Touche Ross' argument—that two separate and severable interests emanate from a bailment and that those interests prevent the bailee from suing as representative of the bailor rather than solely in his own interest as bailee—is also contradicted by three elementary principles of bailment law: (1) either the bailor or bailee can bring an action for the same injury to the bailed property, and a recovery by one is a bar to a subsequent recovery by the other; (2) a bailee can sue for a full recovery beyond the extent of its own direct harm and regardless of any pre-existing liability it might have to the bailor; and (3) the bailee holds such recovery in trust for the bailor. As the New York Court of Appeals explained in *Rogers* v. *Atlantic, Gulf & Pacific Co.*, 213 N.Y. 246, 258-259, 107 N.E. 661, 664 (1915):

> "A bailee, though not liable to the bailor, may recover for the wrongful act of a third party resulting in the loss of, or injury to, the subject of the bailment. * * * If the bailee recovers, he holds the recovery as trustee for the bailor. A recovery by either bailor or bailee will bar an action by the other."

Nothing in *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), undercuts the propriety of the Trustee's assertion of claims as bailee to replenish the fund of customer property under Section 17. *Caplin* did not involve a SIPA Trustee with special duties to marshal and return to customers funds of "customer property" that are recognized as being separate from the debtor's own assets. In *Caplin*, no question of bailment law was presented. All *Caplin* held was that a Chapter X Trustee lacked standing to sue an indenture trustee for defaulting on its obligations to debenture holders. No one contended in *Caplin* that the corporate debtor (or its trustee) was a bailee of the money invested in the debtor by its debenture holders.[21]

Touche Ross' attempt to extrapolate from the rationale of *Caplin* an argument that granting standing to the Trustee would be inconsistent with the rights of customers and lead to a multiplicity of litigation (T.R. Br. at 98) also fails. In the first place, as discussed above, there is no reason to anticipate that many individual customers will have unsatisfied claims (or indeed any compensable damage) under the new SIPA; that statute is intended to ensure that unsatisfied claims become the rarest of exceptions, not the general rule. Second, in the exceptional cases where such claims may arise and be permitted by the courts, it is axiomatic under the law of bailment that

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21. The other two cases cited by Touche Ross in this section of its brief are also not in point because neither involved a SIPA Trustee's responsibilities to marshal and return customers' property to a broker-dealer's customers. *Lank* v. *New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977) involved a Delaware receiver, not a SIPA Trustee. Customer accounts had been transferred to other brokers. The broker's stewardship of customer's property was not involved in the decision; the receiver did not assert any claims as bailee for customers. *Miller* v. *New York Produce Exchange*, 550 F.2d 762 (2d Cir. 1977), involved only a bankruptcy trustee suing for damages to the bankrupt under the Bankruptcy Act; it, too, did not involve claims by the Trustee as bailee of customer property or the question of a trustee's capacity to sue for such claims.

any recovery by the Trustee as bailee would be held in trust for customers and would be binding *pro tanto* on the individual customer-bailors.[22] See ***supra at*** 58.

Not only is the Trustee an appropriate person to sue malefactors such as Touche Ross on behalf of fund claimants, but he is the most desirable plaintiff who could do so. As a result of his extensive pre-complaint investigation into the circumstances surrounding Touche Ross' role in the Weis *debacle,* the Trustee was (and a SIPA Trustee is likely always to be) in the best position to determine whether suit was justified in the first place, and is now (and a SIPA Trustee is likely always to be) in the best position to represent effectively the interests of all unsatisfied customers. If the goal of maximum customer protection under the Exchange Act is to have more than pious content, *someone* must be permitted to bring Section 17 actions to recover for loss to the fund of customer property caused by negligent, grossly negligent and reckless audits. As bailee of customer property, the Trustee is an appropriate plaintiff to pursue that action for customers.

22. The theoretical problem of multiplicity of lawsuits for the same loss to customer property might also be alleviated in future liquidations by use of assignments to the Trustee or SIPC of customers' rights, a possibility contemplated in SIPA. Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 9, (§ 8(b) as amended), 92 Stat. 262. *See SEC* v. *Albert & Maguire Securities Co.,* 560 F.2d 569, 573-74 (3d Cir. 1977).

Conclusion

For the foregoing reasons, as well as those set forth in SIPC's brief, the judgment of the Court of Appeals should in all respects be affirmed.

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APPENDIX

APPENDIX OF STATUTES

Securities Exchange Act of 1934

Section 27, 15 U.S.C. § 78aa:

Jurisdiction of Offenses and Suits

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district where in the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

Securities Investors Protection Act of 1970, as in effect prior to the Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249 (1978)

Section 6(a)(1), 15 U.S.C. 78fff(a)(1):

(a) General purposes of liquidation proceeding.— The purposes of any proceeding in which a trustee has been appointed under section 78eee(b) (3) of this title

(hereafter in this section referred to as a "liquidation proceeding") shall be:

(1) as promptly as possible after such appointment and in accordance with the provisions of this section—

(A) to return specifically identifiable property to the customers of the debtor entitled thereto;

(B) to distribute the single and separate fund, and (in advance thereof or concurrently therewith) pay to customers moneys advanced by SIPC, as provided in subsection (f) of this section;

Section 6(c)(2)(B), 15 U.S.C. §78fff(c)(2)(B):

(B) Single and separate fund.—All property at any time received, acquired, or held by or for the account of a debtor from or for the account of customers except cash customers who are able to identify specifically their property in the manner prescribed in subparagraph (C), and the proceeds of all customers' property transferred by the debtor, including property unlawfully converted, shall constitute a single and separate fund; and all customers except such cash customers shall constitute a single and separate class of creditors, entitled to share ratably in such fund on the basis of their respective net equities as of the filing date and in priority to all other payments, except that (i) there shall be repaid to SIPC, in priority to all other claims payable from such single and separate fund, the amount of all advances made by SIPC to the trustee to permit the completion of open contractual commitments pursuant to subsection (d) of this section, and (ii) to the extent that any other assets of the debtor may be available therefor or as otherwise ordered by the court, all costs and expenses specified in clauses (1) and (2) of section 104(a) of Title 11 shall be paid from such single and separate fund in priority to the claims of such single and separate class of creditors, and any moneys advanced by SIPC for

such costs and expenses shall be recouped as such. If such single and separate fund shall not be sufficient to pay in full the claims of such single and separate class of creditors, the creditors of such class shall be entitled, to the extent only of their respective unpaid balances, to share in the general estate with general creditors. In, or for the purpose of, distributing such fund, all property other than cash shall be valued as of the close of business on the filing date. To the greatest extent considered practicable by the trustee, the trustee shall deliver in payment of claims of customers for their net equities based upon securities held on the filing date in their accounts (after giving effect to open contractual commitments completed as hereinafter provided), securities of the same class and series of an issuer ratably up to the respective amounts which were so held in such accounts. Any property remaining after the liquidation of a lien or pledge made by a debtor shall be apportioned between his general estate and the single and separate fund in the proportion in which the general property of the debtor and the property of his customers contributed to such lien or pledge.

Section 6(c)(2)(C), 15 U.S.C. § 78fff(c)(2)(C):

(C) Specifically identifiable property.—The trustee shall return specifically identifiable property to the customers of the debtor, entitled thereto. No cash or securities at any time received, acquired, or held by or for the account of a debtor from or for the accounts of customers shall for the purposes of this paragraph be deemed to be specifically identified, unless such property remained in its identical form in the debtor's possession until the filing date, or unless such property was allocated to or physically set aside for such customers on the filing date. In determining whether property was allocated to or physically set aside for such customers, it shall be sufficient that on the filing date:

(i) securities are segregated individually, or in bulk for customers collectively;

(ii) in the case of securities held for the account of the debtor as part of any central certificate service of any clearing corporation or any similar depositary--

(I) the records of the debtor show or there is otherwise established to the satisfaction of the trustee that all or a specified part of the securities held by such clearing corporation or other similar depositary are held for specified customers, or for customers collectively, and

(II) such records of the debtor also show or there is otherwise established to the satisfaction of the trustee the identities of the particular customers entitled to receive specified numbers or units of such securities so held for customers collectively; or

(iii) such property is held for the account of customers of the debtor in such other manner as the Commission, for the protection of customers and other creditors on a fair and equitable basis, by rule or regulation shall have determined to be sufficiently identifiable as the property of such customers.

If there is any shortage in securities of the same class and series of an issuer so segregated in bulk or otherwise held for customers pursuant to this subparagraph, as compared to the aggregate rights of particular customers to receive securities of such class and series, the respective interests of such customers in such securities of such class and series shall be prorated, without prejudice, however, to the satisfaction of any claim for deficiencies as otherwise provided in this section.

Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249 (1978)

Section 9, (§ 8(b) as amended), 92 Stat. 262:

(b) PAYMENTS TO CUSTOMERS.—After receipt of a written statement of claim pursuant to subsection

(a)(2), the trustee shall promptly discharge, in accordance with the provisions of this section, all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash, by the delivery of securities or the making of payments to or for the account of such customer (subject to the provisions of subsection (d) and section 9(a)) insofar as such obligations are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee. For purposes of distributing securities to customers, all securities shall be valued as of the close of business on the filing date. For purposes of this subsection, the court shall, among other things—

(1) with respect to net equity claims, authorize the trustee to satisfy claims out of moneys made available to the trustee by SIPC notwithstanding the fact that there has not been any showing or determination that there are sufficient funds of the debtor available to satisfy such claims; and

(2) with respect to claims relating to, or net equities based upon, securities of a class and series of an issuer which are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee, authorize the trustee to deliver securities of such class and series if and to the extent available to satisfy such claims in whole or in part, with partial deliveries to be made pro rata to the greatest extent considered practicable by the trustee.

Any payment or delivery of property pursuant to this subsection may be conditioned upon the trustee requiring claimants to execute, in a form to be determined by the trustee, appropriate receipts, supporting affidavits, releases, and assignments, but shall be without prejudice to any right of a claimant to file formal proof of claim within the period specified in subsection (a)(3) for any balance of securities or cash to which such claimant considers himself entitled.

Section 9, (§ 8(c) as amended), 92 Stat. 262-63:

(c) CUSTOMER RELATED PROPERTY.—

(1) ALLOCATION OF CUSTOMER PROPERTY.—The trustee shall allocate customer property of the debtor as follows:

(A) first, to SIPC in repayment of advances made by SIPC pursuant to section 9(c)(1), to the extent such advances recovered securities which were apportioned to customer property pursuant to section 6(d);

(B) second, to customers of such debtor, who shall share ratably in such customer property on the basis and to the extent of their respective equities;

(C) third, to SIPC as subrogee for the claims of customers;

(D) fourth, to SIPC in repayment of advances made by SIPC pursuant to section 9(c) (2).

Any customer property remaining after allocation in accordance with this paragraph shall become part of the general estate of the debtor. To the extent customer property and SIPC advances pursuant to section 9(a) are not sufficient to pay or otherwise satisfy in full the net equity claims of customers, such customers shall be entitled, to the extent only of their respective unsatisfied net equities, to participate in the general estate as unsecured creditors. For purposes of allocating customer property under this paragraph, securities to be delivered in payment of net equity claims for securities of the same class and series of an issuer shall be valued as of the close of business on the filing date.

(2) DELIVERY OF CUSTOMERS NAME SECURITIES.—The trustee shall deliver customer name securities to or on behalf of a customer of the debtor entitled

thereto if the customer is not indebted to the debtor. If the customer is so indebted, such customer may, with the approval of the trustee, reclaim customer name securities upon payment to the trustee, within such period of time as the trustee determines, of all indebtedness of such customer to the debtor.

(3) RECOVERY OF TRANSFERS.—Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of the Bankruptcy Act. Such recovered property shall be treated as customer property. For purposes of such recovery, the property so transferred shall be deemed to have been the property of the debtor and, if such transfer was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding.

Section 9, (§ 8(d) as amended), 92 Stat. 263:

(d) PURCHASE OF SECURITIES.—The trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities based on securities under section 7(b)(1) and for the transfer of customer accounts under subsection (f), in order to restore the accounts of such customers as of the filing date. To the extent consistent with subsection (c), customer property and moneys advanced by SIPC may be used by the trustee to pay for securities so purchased. Moneys advanced by SIPC for each account of a separate customer may not be used to purchase securities to the extent that the aggregate value of such securities on the filing date exceeded the amount permitted to be advanced by SIPC under the provisions of section 9(a).

Section 9, (§ 8(f) as amended), 92 Stat. 265:

(f) TRANSFER OF CUSTOMER ACCOUNTS.—In order to facilitate the prompt satisfaction of customer claims and the orderly liquidation of the debtor, the trustee may, pursuant to terms satisfactory to him and subject to the prior approval of SIPC, sell or otherwise transfer to another member of SIPC, without consent of any customer, all or any part of the account of a customer of the debtor. In connection with any such sale or transfer to another member of SIPC and subject to the prior approval of SIPC, the trustee may—

(1) waive or modify the need to file a written statement of claim pursuant to subsection (a)(2); and

(2) enter into such agreements as the trustee considers appropriate under the circumstances to indemnify any such member of SIPC against shortages of cash or securities in the customer accounts sold or transferred.

The funds of SIPC may be made available to guarantee or secure any indemnification under paragraph (2). The prior approval of SIPC to such indemnification shall be conditioned, among such other standards as SIPC may determine, upon a determination by SIPC that the probable cost of any such indemnification can reasonably be expected not to exceed the cost to SIPC of proceeding under section 9(a) and section 9(b).

Section 9, (§ 9(a)(1) as amended), 92 Stat. 265:

(a) ADVANCES FOR CUSTOMERS' CLAIMS.—In order to provide for prompt payment and satisfaction of net equity claims of customers of the debtor, SIPC shall advance to the trustee such moneys, not to exceed $100,000 for each customer, as may be required to pay or otherwise satisfy claims for the amount by which the net equity of each customer exceeds his ratable share of customer property, except that—

(1) if all or any portion of the net equity claim of a customer in excess of his ratable share of customer property is a claim for cash, as distinct from a claim for securities, the amount advanced to satisfy such claim for cash shall not exceed $40,000 for each such customer;

Section 15, (§§ 16(4), (5) as amended), 92 Stat. 272:

For purposes of this Act, including the application of the Bankruptcy Act to a liquidation proceeding:

(4) CUSTOMER NAME SECURITIES.—The term 'customer name securities' means securities which were held for the account of a customer on the filing date by or on behalf of the debtor and which on the filing date were registered in the name of the customer, or were in the process of being so registered pursuant to instructions from the debtor, but does not include securities registered in the name of the customer which, by endorsement or otherwise, were in negotiable form.

(5) CUSTOMER PROPERTY.—The term 'customer property' means cash and securities (except customer name securities delivered to the customer) at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted. The term 'customer property' includes—

(A) securities held as property of the debtor to the extent that the inability of the debtor to meet its obligations to customers for their net equity claims based on securities of the same class and series of an issuer is attributable to the debtor's noncompliance with the requirements of section 15(c)(3) of the 1934 Act and the rules prescribed under such section;

(B) resources provided through the use or realization of customers' debit cash balances and other customer-related debit items as defined by the Commission by rule;

(C) any cash or securities apportioned to customer property pursuant to section 6(d); and

(D) any other property of the debtor which, upon compliance with applicable laws, rules, and regulations, would have been set aside or held for the benefit of customers, unless the trustee determines that including such property within the meaning of such term would not significantly increase customer property.

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

—v.—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT—SECURITIES INVESTOR PROTECTION CORPORATION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

—v.—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT—SECURITIES INVESTOR PROTECTION CORPORATION

Preliminary Statement

This brief is submitted by respondent Securities Investor Protection Corporation ("SIPC") in opposition to the brief of petitioner Touche Ross & Co. ("Touche Ross"). SIPC was created by and organized under the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa *et seq.* ("SIPA").[1]

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[1] SIPA was recently amended by the Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249 *et seq.*

A separate brief is being submitted by SIPC's co-plaintiff, Edward S. Redington (the "Trustee"). The Trustee was appointed in May 1973 by order of the United States District Court for the Southern District of New York to liquidate the business of Weis Securities, Inc. ("Weis"), pursuant to SIPA.

SIPC and the Trustee have sought to avoid duplication wherever possible.

Additional Statute Involved

Section 27 of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78aa, is set forth in the appendix to this brief.

Counterstatement of Questions Presented

1. Whether a private right of action based on Section 17(a) of the 1934 Act may be asserted by customers of a brokerage firm against the firm's accountant for losses resulting from the accountant's false certification of reports filed with regulatory agencies pursuant to Section 17(a)?

2. Whether SIPC, which is required by SIPA to advance funds to the Trustee for the payment of claims made by a liquidated brokerage firm's customers, is subrogated to the customers' Section 17(a) right of action against the accountant?

Counterstatement of the Case

This action arises from the audit in May 1972 of Weis, a securities brokerage firm, by Touche Ross, a firm of certified public accountants. Touche Ross was hardly a

stranger to the operations, personnel and financial affairs of Weis when it performed the 1972 audit. For at least four years, Touche Ross had served as Weis' "independent" certified public accountant. In that capacity, Touche Ross purported to audit the affairs of Weis on an annual basis, as required by Section 17(a) of the 1934 Act, the applicable standards of the accounting profession, and the audit regulations of the Securities and Exchange Commission (the "SEC") and the New York Stock Exchange (the "Exchange").

Certain of Weis' officers (the "Weis Five") successfully conspired to conceal substantial operating losses during fiscal year 1972 by falsifying the financial reports required to be filed with the regulatory authorities pursuant to Section 17(a) of the 1934 Act. The devices employed and the transactions involved in the fraud perpetrated by the Weis Five on the public are alleged in great detail in the complaint (A. 8 [¶ 10], 9 [¶ 12], 16 [¶ 29]).[2] For example, Weis' pre-tax earnings were misstated as in the range of $1,700,000 where, in fact, Weis suffered losses in excess of $1,500,000. Thus, at the very least, this action involves Touche Ross' false certification of a 3.2 million dollar fraud.

By the time Weis' true financial condition was finally exposed in 1973, Weis' forced liquidation had become inevitable. Hence, the SEC commenced an action in the United States District Court for the Southern District of New York for injunctive relief to prevent the Weis Five from conducting the business of Weis in violation of the 1934 Act and the rules and regulations promulgated thereunder. SIPC applied to the same Court for a decree adjudicating that Weis' customers were in need of the

[2] Numerals preceded by the letter "A." refer to the pages of the separate Appendix filed with the Court. The facts summarized herein are those alleged in the complaint (A. 5-33).

protection afforded to them by Congress in SIPA.[3] The decree was granted, the liquidation of Weis was ordered, and the Trustee was appointed to liquidate the business of Weis. Consequently, SIPC was required by SIPA to provide, and did provide, to the Trustee at least fourteen million dollars for the payment of liquidation claims submitted by Weis' customers.

The means by which Weis' massive fraud was perpetrated on the SEC, the Exchange, SIPC and Weis' customers were the reports Weis was required to file with the SEC and the Exchange pursuant to Rule 17a-5, promulgated under Section 17(a) of the 1934 Act. These reports play a role of paramount importance in the scheme devised by Congress in the 1934 Act and SIPA, and effectuated by the regulatory authorities, for the protection of customers who entrust their cash and securities to broker-dealers. Weis was a member of SIPC, but SIPC has no authority to examine its members.[4] Rather, it relies entirely on the self-regulatory organization to which the SIPC member belongs (in the case of Weis, the Exchange) to examine the broker-dealer for compliance with the applicable financial responsibility rules, and to alert SIPC to the broker-dealer's financial difficulty. The self-regulatory organization, in turn, relies on the Rule 17a-5 reports certified by the broker-dealer's accountants (here, Touche Ross) to determine whether the broker-dealer is in compliance with these rules and thus financially sound. And, of course, the broker-dealers' customers (to whose rights against wrongdoers SIPC is subrogated here) rely on the efficacy of the statutory and regulatory system created for their protection and are dependent upon the accountants' Rule 17a-5 certifications.

[3] The Weis Five were subsequently indicted and convicted.

[4] SIPC is a quasi-governmental, non-profit membership corporation whose membership consists of virtually all the broker-dealers in this country.

In sum, the protection of the customer (and hence of the SIPC fund) is effectuated only so long as the accountant certifying the Rule 17a-5 reports performs that crucial obligation responsibly. Here, Touche Ross performed that obligation not only irresponsibly, but with such dereliction as borders on, indeed may well constitute, fraud. As a result, Weis' customers—the "favored wards" of Section 17(a) (A. 200)—were deprived of the protection Congress intended them to have when it enacted that statute.

A. *The Basis For The Action Against Touche Ross*

Touche Ross, with full awareness of its public obligations and statutory duties, falsely certified as correct and complete the palpably fraudulent financial statements of Weis. Specifically, based on its audit of Weis for fiscal year 1972, Touche Ross (a) prepared and certified Weis' answers to the financial questionnaire required by the Exchange (A. 42); (b) prepared and certified Weis' financial statements (A. 67); and (c) issued four opinion letters attesting to the accuracy of the financial statements and to the proper discharge of Touche Ross' responsibilities as auditor (A. 37, 45, 69, 87).

The reports of Weis' financial condition at fiscal year-end 1972, required to be filed with the regulatory authorities pursuant to Section 17(a), were intended for, and were relied upon by, SIPC, the Exchange, the SEC, and Weis' customers. Touche Ross certainly knew that these organizations would rely on the results of its audit to determine whether Weis was in compliance with the applicable financial responsibility rules, and to discover whether Weis was in financial difficulty. Similarly, Touche Ross certainly knew that Weis' customers would rely on the audit to determine whether to entrust, or to continue to entrust, their cash and securities to Weis.

Had Touche Ross conducted its audit in the manner which it represented in its opinion letters and certifications, it would have discovered the mammoth fraud perpetrated by the Weis Five and would have had a corresponding legal obligation to disclose it. The components of the fraud are set forth in extraordinary detail in the complaint. *See, e.g.*, A. 16 [¶29].

However, as a direct result of Touche Ross' unjustifiable failure promptly to discover and disclose Weis' true financial condition, any possibility of timely remedial action was lost, Weis was subsequently unable to comply with the minimum financial responsibility rules, and its liquidation became inevitable.

B. *SIPC And Its Claims Against Touche Ross*

As previously noted, SIPC was created and organized under SIPA, the background and purposes of which were summarized by this Court in *SIPC* v. *Barbour*, 421 U.S. 412 (1975), as follows:

> "Following a period of great expansion in the 1960's, the securities industry experienced a business contraction that led to the failure or instability of a significant number of brokerage firms. Customers of failed firms found their cash and securities on deposit either dissipated or tied up in lengthy bankruptcy proceedings. In addition to its disastrous effects on customer assets and investor confidence, this situation also threatened a 'domino effect' involving otherwise solvent brokers that had substantial open transactions with firms that failed. Congress enacted the SIPA to arrest this process, restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered brokers and dealers." *Id.* at 415.

The last stated purpose, that of up-grading broker-dealer financial responsibility, was aimed at eliminating "to the maximum extent possible, the risks which lead to customer loss." H.R. Rep. No. 91-1613, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5254, 5255.

SIPA accomplished its purposes essentially by two methods. First, SIPA enhanced the SEC's power to establish financial responsibility rules for broker-dealers, and to impose on the self-regulatory organizations' requirements for the financial examination of their members.[5] This first method by which SIPA's purposes were to be accomplished was subverted by Touche Ross because its false certification of Weis' fraudulent Section 17(a) reports deceived the SEC, the Exchange, SIPC and Weis' customers into assuming that Weis was in compliance with the financial responsibility rules to which it was subject.

The second method by which SIPA accomplished its purposes was the creation of SIPC, which was empowered, *inter alia*, to commence proceedings for the liquidation of its members whose financial condition posed the threat of loss to their customers; and to satisfy, within certain limits, the claims of those customers against the SIPC member's estate. As a result of the belated discovery of Weis' true financial condition and of its consequent liquidation, SIPC advanced over fourteen million dollars to the Trustee for the satisfaction of Weis' customers' claims.

After a lengthy and thorough investigation of the circumstances which brought about the Weis liquidation—and particularly of Touche Ross' role therein—SIPC and the Trustee commenced this action against Touche Ross on April 30, 1976 in the District Court for the Southern District of New York.[6]

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[5] *See, e.g.*, §§ 7(d), 9, 9(e) of SIPA.

[6] SIPC and the Trustee have also commenced a state court action against Touche Ross, which is virtually dormant. That action is

(Footnote continued on next page)

SIPC asserts eight claims in its complaint. Four of these claims are asserted in SIPC's own right (A. 24, 26, 28, 29), and the other four are asserted by SIPC as the subrogee of those Weis customers whose liquidation claims have been satisfied by payments from the SIPC fund (A. 25, 27, 29, 30). Two of SIPC's direct claims and two of its subrogation claims are predicated upon the 1934 Act (A. 24-27), and the remaining four claims plead Touche Ross' common law liability (A. 28-30). Two of the 1934 Act claims assert that Touche Ross aided and abetted the Weis Five's violation of the 1934 Act (A. 26, 27).

The 1934 Act claims are based upon Touche Ross' breach of the duty imposed upon it by Section 17(a), as to which federal jurisdiction is exclusive under Section 27 of the 1934 Act. The common law claims are asserted on the basis of pendent jurisdiction.[7]

C. *The Purpose And Function Of Section 17(a) And Rule 17a-5*

As in effect in 1972, Section 17(a) required broker-dealers to "make such reports, as the [Securities and Exchange] Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors." Pursuant to this provision, the SEC adopted Rule 17a-5 which required broker-dealers to file reports of their financial condition at least annually on a Form X-17A-5.

Prior to the adoption of the rule, the SEC noted that customer protection against the risk involved in leaving securities with broker-dealers would be increased by Rule 17a-5. *National Association of Securities Dealers,* 12 S.E.C. 322, 339 n.9 (1942).

In order to effectuate that purpose of customer protection, Rule 17a-5 called for the gathering, analysis and disclosure of a broad range of information.[8] This information was intended to provide a detailed and complete picture of the financial condition of the broker-dealer, and of the procedures and controls employed by the broker-dealer for safeguarding the property of its customers.

The single most important function of the information filed pursuant to the mandate of Section 17(a) and the requirements of Rule 17a-5 was to assure the SEC and the self-regulatory organizations that the broker-dealer was in compliance with the "net capital" rule, which required the broker-dealer to maintain a certain minimum ratio of liquid assets to aggregate indebtedness.[9] The net capital rule

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(Footnote continued from preceding page)
far less comprehensive than the federal action since no Section 17(a) claims are asserted therein. Moreover, as the Court of Appeals noted: "[T]he state court action was commenced first only in a highly technical sense. It was begun [in July 1975] by service of a summons without complaint (the complaint was not served until after filing of the federal complaint), and then apparently ignored for some months by mutual consent." (A. 195 n.7). It should also be noted that the Court of Appeals, in remanding the federal action, expressly left it for the District Court to decide whether the action should be stayed pending determination of the state court action. Touche Ross has asserted in the state court action that—as a matter of law—it is not liable to third-parties such as Weis' customers and SIPC. See Trustee's Brief at 13-15.

[7] The Court of Appeals expressly left it for the District Court to decide, on remand, whether to exercise pendent jurisdiction over SIPC's common law claims (A. 204).

[8] The discussion herein is with respect to Section 17(a) and Rule 17a-5 as in effect in 1972, at the time of Touche Ross' audit of Weis. Since then, the Rule has been amended to require the gathering, analysis and disclosure of an even broader range of information. Section 17(a) and Rule 17a-5 are included in the appendix to Touche Ross' brief.

[9] As a member of the Exchange, Weis was exempt from the SEC's net capital requirements because it was subject to the more stringent net capital requirements of Exchange Rule 325, promul-

(Footnote continued on next page)

has been described as the "principal regulatory tool" used by the SEC to monitor the financial soundness of brokers and dealers. Press Release, January 10, 1973 [1972-73 Transfer Binder] FED. SEC. L. REP. (CCH), ¶ 78,174 at 82,578. As the SEC has stated:

> "The principal purpose of the [net capital] rule is to require that the capital position of a broker or dealer will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers." Exchange Act Release No. 8024 [1967] 5 FED. SEC. L. REP. (CCH) ¶ 72,129 (subsequently rescinded and omitted).

More recently, the SEC announced certain amendments to the net capital rule and reiterated its essential purpose, as follows:

> "[T]he amount of the firm's liquid assets in excess of the broker's or dealer's minimum requirement necessary to protect customers gives the [SEC], self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time when the broker's or dealer's assets would be insufficient to satisfy customers claims in the event of liquidation." Exchange Act Release No. 11497 [1975-76 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,212.

Of course, the net capital rule effectuates congressional policy, for as is noted in the legislative history underlying the enactment of SIPA:

(Footnote continued from preceding page)
gated by the Exchange pursuant to Section 6(d) of the 1934 Act. Accordingly, Weis was not permitted to allow its "aggregate indebtedness" to exceed 1500% of its "net capital" as those terms are defined in Exchange Rule 325. (The SEC's rule required a less stringent 20 to 1 ratio.)

> "Congress did not intend to permit a broker to continue operations unless he had on hand cash or liquid assets in the required ratio to aggregate indebtedness." H.R. REP. No. 91-1613, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5254, 5266.

As previously explained, the very means for determining and enforcing net capital compliance are rooted in Section 17(a). Rule 17a-5 promulgated under the section required the filing of Form X-17A-5 which was "designed to reflect the financial condition of the reporting broker and dealer; and, accordingly, it contains details calculated to reveal whether or not the broker-dealer is in compliance with, among other things, applicable 'net capital' requirements." [10]

Accordingly, as the Court of Appeals here recognized:

> "It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows." (A. 198).

D. *The Accountants' Role And Duty With Respect To The Section 17(a) Filings*

While Weis' Section 17(a) reports were filed with the SEC and with the Exchange, neither of these organizations

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[10] REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 24 (1971). This report was made pursuant to Section 11 of SIPA, which directed the SEC to report to Congress concerning unsound broker-dealer practices and to make recommendations for their elimination.

verified, nor were they expected to verify, the information contained in the reports. Instead, both the SEC and the Exchange relied on the Touche Ross certifications as to the accuracy of these reports, and thus were misled as to Weis' compliance with the net capital rule.

As in effect in 1972 when Touche Ross facilitated the massive deception caused by Weis' Section 17(a) reports, Rule 17a-5 required that:

— the report to be filed by the broker-dealer "be certified by a certified public accountant or a public accountant who shall be in fact independent" [Rule 17a-5(b)(1)];[11]

— the accountant's certificate contain, *inter alia*, "a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers" [Rule 17a-5(g)(2)];

— the accountant's certificate "state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein" [Rule 17a-5(h)]; and

— "[a]ny matters to which the accountant takes exception shall be clearly identified . . . specifically and clearly stated . . . [and] the effect of each such exception on the related item of the report shall be given" [Rule 17a-5(i)].

[11] Significantly, an accountant's certificate was not required if the broker-dealer's business was such as would not expose customer cash or securities to the risk of loss. See proviso in Rule 17a-5(b)(1).

Even more importantly, Form X-17A-5 required that:

"AUDIT REQUIREMENTS

The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. It shall include all procedures necessary under the circumstances to substantiate the assets and liabilities and securities and commodities positions as of the date of the responses to the financial questionnaire and to permit the expression of an opinion by the independent public accountant as to the financial condition of the respondent at that date. Based upon such audit, the accountant shall comment upon any material inadequacies found to exist in the accounting system, the internal accounting control and procedures for safeguarding securities, and shall indicate any corrective action taken or proposed. These comments may be submitted in a supplementary certificate and filed pursuant to Rule 17a-5(*b*) (2). . . ." (emphasis added).

This was followed by a comprehensive list of the procedures to be conducted by the auditor, and concluded with:

"NOTE: PROVISIONS OF RULE 17a-5 REQUIRE THAT THE REPORTS OF CERTAIN BROKERS AND DEALERS BE AUDITED BY A CERTIFIED PUBLIC ACCOUNTANT OR PUBLIC ACCOUNTANT WHO SHALL BE IN FACT INDEPENDENT. WITH RESPECT TO QUALIFICATIONS OF ACCOUNTANTS, ACCOUNTANT'S CERTIFICATE, OPINIONS TO BE EXPRESSED, AND EXCEPTIONS, PLEASE REFER TO RULE 17a-5." (as printed in original).

In view of the foregoing explicit requirements in Rule 17a-5 and Form X-17A-5, it can hardly be doubted that

specific and crucial obligations were imposed upon accountants pursuant to Section 17(a).[12]

It is also important to note that Congress considered, but ultimately rejected, requiring the government itself to audit SEC filings. Instead, Congress chose to have such filings audited by independent public accountants. *See,* SEC Accounting Series Release No. 81 [1958] 5 FED. SEC. L. REP. (CCH) ¶72,103.[13]

Moreover, among the early amendments to Rule 17a-5[14] was a broadening of the certification requirements, which occasioned the following statement in the SEC News Digest for August 8, 1957 (at 3):

> "[The amendment] . . . adds another important protective feature to the . . . [SEC's] continuing program for improving the safeguards afforded to customers of broker-dealer firms. . . . *The . . . [SEC] believes that it is essential, for the protection of public investors, that the accounts of these broker-dealers who do business with the investing public and handle customers' funds and securities be subject to an annual audit by an independent accountant.*" (emphasis added).

[12] As to Touche Ross' novel contention that it was not subject to a duty under Section 17(a) because the obligations imposed upon it emanated from Rule 17a-5, and not from the statute, see pp. 30-31, *infra.*

[13] *See also* Sonde, *The Responsibility of Professionals Under the Federal Securities Laws—Some Observations,* 68 NW. U.L. REV. 1, 2 (1973) ("Although it was initially proposed that the Government hire a corps of auditors to perform the audit responsibility for financial statements filed with the [SEC], it was decided that such statements be audited by independent public accountants. This decision was based upon the accounting profession's representation that it was willing and able to assume this responsibility.")

[14] Adoption of the amendment to Rule 17a-5(b)(1) was announced in Exchange Act Release No. 5560 [1957-61 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 76,532.

Indeed, the accounting profession itself has recognized that accountants bear a responsibility not only to the brokers who hire them, but especially to the brokers' customers and the regulatory authorities who rely on their certifications as to the brokers' financial soundness:

> "The forms of financial reporting of broker-dealers, in accordance with requirements established by the regulatory or self-regulatory bodies, are intended to meet the needs of customers who do business with the securities concerns, the regulatory bodies and, in the case of firms with public ownership, the needs of stockholders." AICPA, AUDIT OF BROKERS AND DEALERS IN SECURITIES xi (1977).[15]

In fact, a Touche Ross partner who worked on the very 1972 Weis audit which underlies this action has written that:

> "[I]t is our responsibility to determine when financial statements do not present fairly the financial position of a company. Therefore, if a fraud is so pervasive as to destroy the very fabric of the financial statements we audit, we must strive to detect this condition. We may not always be successful, but we cannot afford to fall back on the thinking that collusive actions always defeat internal controls and circumvent audit techniques. *This negativism would stultify all efforts to discover such problems and thus be abandonment of duty.* Therefore, I believe that the performance gap between public (here, the SEC) expectations and reality can be narrowed." Weinstein, *A Time of Travail*

[15] *See also In re Touche, Niven, Bailey & Smart,* Accounting Series Release No. 78 [1957] 5 FED. SEC. L. REP. (CCH) ¶ 72,100 at 62,212.

and Challenge, 44 C.P.A. J. 29 (Dec. 1974) (emphasis added).[16]

The rules and forms promulgated under Section 17(a) constitute an "early warning system" which is designed to detect the financial unsoundness of broker-dealers at the earliest possible moment. Accountants play the pivotal role in that system and their certifications of Section 17(a) reports are the *only* means through which the SEC and the self-regulatory organizations are assured that broker-dealers are not in violation of the net capital rule. It is against this background that the Court of Appeals here held that Section 17(a) imposes a duty upon accountants. (A. 195-96).

E. *The Opinions Below*

The District Court (Wyatt, J.) dismissed the complaint, holding that Section 17(a) does not create any rights of action in anybody (A. 177). The Court of Appeals reversed, holding that (1) brokers' customers have a right of action under Section 17(a) against accountants (A. 201); (2) that SIPC may assert that right of action as the customers' subrogee (A. 201); and (3) that the Trustee, as the bailee of Weis' customers' property, may assert that right of action on behalf of those customers who have not been fully reimbursed by SIPC.[17]

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[16] In its answers to plaintiffs' preliminary interrogatories in this action, Touche Ross listed Mr. Weinstein as one of its partners who had worked on the 1972 Weis audit.

[17] In a footnote, the Court of Appeals also stated that "[it] need not reach the question whether SIPC could ever have a claim for damages other than on behalf of broker's customers," and went on to express doubt as to SIPC's right to assert a Section 17(a) right of action in its own behalf (A. 201 n.13). This aspect of the Court of Appeals decision is addressed in SIPC's conditional cross-petition for certiorari (No. 78-526), which is still *sub judice.*

Summary Of Argument

I

A. The assertion of a private right of action herein is rooted in the longstanding principle that the members of a class for whose protection a statute was enacted have a right of action for its breach, particularly where the remedy also serves to vindicate and effectuate the congressional purpose underlying the statute. Applying the traditional "statutory tort" doctrine as it has evolved in modern decisional law on implied rights of action, it is clear that all the requisite elements for a legally cognizable claim for relief are present in this case. Thus, Weis' customers are the very persons Congress sought to protect under Section 17(a); Touche Ross has breached its duty to such persons under Section 17(a) to their damage; there is no indication of congressional intent to deny such a private right of action; and a federal right of action is necessary and appropriate to further the congressional purpose of safeguarding customers' securities and cash entrusted to broker-dealers.

B. Touche Ross shuns an analysis of the relevant factors to be considered in this case, as summarized by this Court in *Cort* v. *Ash,* 422 U.S. 66 (1975), and instead makes the specious argument that enactment of Section 18(a) of the 1934 Act indicates an explicit congressional intention to deny private rights of action to customers under Section 17(a). This argument ignores the obvious fact that the two sections are clearly intended to deal with investors in different capacities, and seek to protect against two distinct types of wrongs. The purpose of

enacting Section 17(a) was to protect investors in their capacity as customers entrusting securities or cash to their broker-dealers. Under this section, an elaborate system was structured involving certification of brokers' financial conditions by independent auditors in order that the regulatory bodies would learn promptly of brokers' financial difficulties. On the other hand, Section 18(a) was enacted for the benefit of investors in their capacity as purchasers or sellers of securities who are injured by reason of their justifiable reliance on false statements filed by corporate issuers. Thus, analysis of the purpose and function of each of the sections establishes that Section 18(a) does not deal with or reach the intended beneficiaries of Section 17(a) or the wrongs that section seeks to forestall.

It is clear that Section 18(a), which is limited to actions based on the purchase or sale of securities, was not intended to, and indeed does not, provide a remedy for a violation of Section 17(a), which deals with reports filed by broker-dealers.

Touche Ross and the dissent below conclude, not merely that Section 18(a) covers violations of Section 17(a), but that "section 18(a) expressly provides the *sole private remedy* which Congress *intended* to be available for a violation of Section 17(a). . . ." (A. 211) (emphasis added). There is no support for this conclusion in the legislative history of either section; indeed, the contrary is indicated.

C. There is also nothing in the cases cited by Touche Ross as "controlling" which suggests that a private right of action should not be implied herein. In *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("Amtrak"), and *SIPC* v. *Barbour*, 421 U.S. 412 (1975), the Court declined to imply

a private right to sue to enforce the particular Act because it found clear legislative intent to deny such a right and because it concluded that the implication of such a right would be inconsistent with the effectuation of the purpose of the Act.

In this case implication of a private right of action would be consistent with the underlying purposes of the 1934 Act and, indeed, is necessary in order to effectuate the purposes of Section 17(a). Such a private remedy would constitute a necessary supplement to SEC action and would act as a deterrent against further abuses.

II

D. SIPC was required to, and did, advance funds to the Trustee for the satisfaction of customers' claims made against the Weis estate. Thus, under the fundamental common law doctrine of equitable subrogation, SIPC is subrogated to the rights Weis' customers could have asserted against Touche Ross, the wrongdoer, had their claims not been satisfied by the funds advanced to the Trustee by SIPC.

E. Nothing in SIPA or in its legislative history suggests that Congress intended SIPC's statutory subrogation right to customers' claims against the broker's estate to be SIPC's exclusive subrogation remedy. In fact, it appears that Congress intended just the opposite. Indeed, Congress incorporated SIPA into the 1934 Act which expressly provides that common law rights and remedies are to be preserved.

Moreover, the statutory subrogation right in SIPA appears in the context of a detailed blueprint for the

distribution of a liquidated debtor's estate. There is no such comprehensive scheme in SIPA as to rights *outside* a liquidation proceeding, and thus there was no need to define SIPC's common law subrogation right.

Congress' generally expressed policy was to maximize SIPC's recovery of the funds it expends in the course of broker-dealer liquidations. Certainly, SIPA was not enacted so as to shift liability from wrongdoers, such as Touche Ross, to SIPC. Finally, considerations of public policy require that SIPC's common law subrogation rights be preserved.

ARGUMENT

I

The Court Of Appeals Correctly Held That, As The "Favored Wards" Of Section 17(a) Of The 1934 Act, Customers Of A Stockbrokerage Firm Have A Right Of Action Under That Section Against The Firm's Accountants Who Breach The Duty Imposed Upon Them By The Section

The holding by the Court of Appeals adheres to—indeed, is mandated by—the longstanding principle that the members of a class for whose protection a statute was enacted have a right of action for its breach, especially where the remedy also serves to vindicate and effectuate the congressional purpose underlying the statute.

As the Court of Appeals recognized: Weis' customers are none other than the very persons Congress sought to protect under Section 17(a); SIPC, as their subrogee, is

seeking to vindicate the very purpose which underlies the section, viz., the safeguarding of customers' cash and securities entrusted to broker-dealers; and a federal right of action under Section 17(a) is necessary and appropriate to further that congressional purpose.

In an attempt to obfuscate the application of the considerations relevant to the issue before this Court, Touche Ross has studiously avoided any meaningful discussion or analysis of the implied rights doctrine. Instead, it seizes upon Section 18(a) of the 1934 Act—which in no way addresses the concerns of Section 17(a) or its purposes—and proceeds to build a convoluted and lengthy argument upon the faulty premise that the two sections are closely related. As a result of this and other serious flaws, including a disjointed treatment of the relevant decisions of this Court, Touche Ross' discussion and analysis of the questions presented are neither analytical nor illuminating.

A. *The Existence Of Section 18(a) Is Not A Material Consideration To The Issue Before This Court*

Despite the length of its brief, Touche Ross fails to analyze Section 17(a) in terms of its particular purpose and place in the overall statutory scheme. The purpose of the 1934 Act is to protect investors in their three basic spheres—as purchasers and sellers of corporate securities (the transactional sphere); as customers of brokers and dealers (the bailment sphere); and as shareholders in direct relationship with their corporations (the corporate relationship sphere). Sections 8, 15 and 17(a) deal with, and offer protection to, investors in the bailment sphere. Other sections, such as 10(b) and 18, are addressed to, and protect, investors in the transactional sphere. Yet other sections, such as 14(a), protect investors in the corporate relationship sphere.

The essential flaw in Touche Ross' entire approach to the issue presented herein is its refusal to appreciate—or acknowledge—the basic distinctions within the statutory scheme as to the capacity in which an investor is sought to be protected, and as to the means of protection sought to be afforded. Consequently, Touche Ross' premises regarding "the statutory scheme of the 1934 Act" and its exclusive focus on the existence of Section 18(a), are faulty.

Section 18(a) simply does not deal with or reach the intended beneficiaries of Section 17(a) or the wrongs which it seeks to forestall. Therefore one cannot conclude, as does Touche Ross and the dissent below, "that Section 18(a) expressly provides the sole private remedy which Congress intended to be available for a violation of Section 17(a). . . ." (A. 211).

B. *The Historical Development Of The Doctrine Of Implied Rights Of Action And The Relevant Factors To Be Considered*

That the federal courts may imply private remedies from federal statutes is a longstanding doctrine, originating in English jurisprudence and based upon the common law tort principle that the violation of a statute makes the actor liable to another person if the intent of the statute is to protect that person from the particular harm caused.[18] See RESTATEMENT OF TORTS § 286 (1934).[19]

[18] "[I]n every case, where a statute enacts or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage or for the recompence of a wrong done to him contrary to the said law." I Comyn's Digest 248 (1762), quoted in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33, 39 (1916).

[19] The most recent draft of the Restatement of Torts provides that "in furtherance of the purpose of particular legislation" a court may "supply a civil action for damages affording relief to a

(Footnote continued on next page)

This "statutory tort" doctrine was enunciated by this Court in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33, 39 (1916). In holding that a railroad switchman could recover from his employer for injuries resulting from a violation of federal railroad safety legislation, this Court stated:

> "A disregard of the command of the statute is a wrongful act, and where it results in damages to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is *implied*. . . ." (emphasis added).

Relying on the Restatement of Torts and this Court's teaching in *Rigsby*, the district court in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), first applied this doctrine to the federal securities laws, ruling that shareholders who were induced to sell their stock by fraudulent misrepresentation could recover under Section 10(b) of the 1934 Act and Rule 10b-5.[20] Three years later, the court in *Hawkins* v. *Merrill Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949), in reliance upon *Kardon*, recognized a private right of action under Section 17(a) and Rule 17a-5—the very provisions at issue in this case.[21]

(Footnote continued from preceding page)

person for whose benefit conduct of another was either proscribed or required by the legislation." RESTATEMENT (SECOND) OF TORTS § 874A (Tent. Draft No. 22, 1976).

[20] This Court has repeatedly confirmed the existence of a private right of action under Section 10(b) and Rule 10b-5. *See, e.g., Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); and *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

[21] Touche Ross incorrectly states that "[i]n the 45 years since enactment of the 1934 Act . . . [not] a single court . . . [found] it appropriate—let alone 'necessary'—to imply a private right of action for damages under Section 17(a)." Petitioner's Brief at 63.

More recently, in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), this Court unanimously held that an implied cause of action for damages existed in favor of shareholders of a corporation under Section 14(a) of the 1934 Act for deceptive proxy solicitations in violation of that provision.[22] Subsequently, in *Wyandotte Transportation Co.* v. *United States*, 389 U.S. 191 (1967), a unanimous court reaffirmed the basis of the *Rigsby* and *Borak* decisions as follows:

> "Because the interest of the plaintiffs in those cases fell within the class the statute was intended to protect, and because the harm that had occurred was of the type that the statute was intended to forestall, we held that civil actions were proper. That conclusion was in accordance with a general rule of the law of torts. See Restatement (Second) of Torts, § 286." *Id.* at 202.

In 1974 this Court was faced with a situation wherein an implied private right of action was being urged despite the fact that (a) there was clear legislative intent to deny such a right, and (b) the implication of such a right would subvert the underlying purposes of the statute. Thus, in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("Amtrak"), this Court noted that:

> "the inference of . . . a private cause of action not otherwise authorized by the statute must be consistent with the evident legislative intent and, of course, with the effectuation of the purposes intended to be served by the Act." *Id.* at 458.

The following Term, in *SIPC* v. *Barbour*, 421 U.S. 412, 418 (1975), this Court reaffirmed the relevance of the above-quoted considerations in determining the propriety of implying a private right of action.

[22] *See also Mills* v. *Electric Auto-Lite*, 396 U.S. 375 (1970).

Subsequently, in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), this Court harmonized the considerations applied in *Amtrak* and *Barbour* with the earlier statutory tort test and synthesized the factors to be examined in determining whether a private right of action should be implied under a particular statute.[23]

In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), this Court's most recent decision addressing the assertion of an implied right of action under the 1934 Act, the Court reaffirmed the relevance and utility of the *Cort* v. *Ash* analysis.

C. *Cort v. Ash Provides A Useful Framework For Considering Whether A Private Right Of Action Should Be Implied Under Section 17(a)*

Cort v. *Ash*, with its recitation and analysis of the relevant considerations, provides a useful framework for considering the issue presented herein.

Citing *Rigsby*, the *Cort* analysis begins with the primary consideration of whether the plaintiff is a member of a class for whose special benefit the statute was enacted, "that is, does the statute create a federal right in favor of the plaintiff?" 422 U.S. at 78. It then determines whether a traditional remedy for the violation of that right should be withheld by considering particular legislative intent, overall statutory purpose and scheme, and questions of federalism.

Seizing upon a particular phrase in the *Cort* opinion,[24] Touche Ross argues that in Section 18(a) a private remedy for violation of Section 17(a) is expressly provided

[23] The four factors in *Cort* v. *Ash* are set forth *infra* at 26-27.

[24] "In determining whether a private remedy is implicit in a statute *not expressly providing one*, several factors are relevant." 422 U.S. at 78 (emphasis added).

for and therefore *Cort* "does not set forth the appropriate analysis here." Petitioner's Brief at 40. Touche Ross then concludes that the appropriate analysis is set forth in *Amtrak, Barbour* and *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). *Id.* As will be demonstrated, *infra* at 33-34, 36, because Section 18(a) does not address or enter the sphere in which Section 17(a) was meant to operate, it cannot be said to extinguish traditional remedies provided to the intended beneficiaries of Section 17(a). It will be seen that Touche Ross' "argument" as to the inappropriateness of an analysis under *Cort* cannot stand.

Finally, as will also be demonstrated, *infra* at 37-42, not only are *Amtrak, Barbour* and *Blue Chip* entirely beside the mark as controlling cases, there is nothing in or about those decisions which compels or even suggests the conclusion that a private right of action should not be implied under Section 17(a).

D. *Consideration Of The Relevant Factors Compels The Conclusion That A Private Right Of Action Should Be Implied In Favor Of Brokers' Customers*

The factors to be considered were summarized in *Cort* as follows:

> "In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,' *Texas & Pacific R. Co.* v. *Rigsby,* 241 U.S. 33, 39 (1916) (emphasis supplied)—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? See, *e.g., National Railroad Passenger Corp.* v. *National Ass'n. of Railroad Passengers,* 414 U.S. 453, 458, 460 (1974) (*Amtrak*). Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? See, *e.g., Amtrak, supra; Securities Investors Protection Corp.* v. *Barbour,* 421 U.S. 412, 423 (1975); *Calhoon* v. *Harvey,* 379 U.S. 134 (1964). And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? See *Wheeldin* v. *Wheeler,* 373 U.S. 647, 652 (1963); cf. *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 434 (1964); *Bivens* v. *Six Unknown Federal Narcotics Agents,* 403 U.S. 388, 394-395 (1971); id., at 400 (Harlan, J., concurring in judgment)." 422 U.S. at 78.

An application of these factors to the instant case indicates the propriety of implying a private right of action under Section 17(a) in favor of brokers' customers.

1. *Brokers' Customers Are The Special And Intended Beneficiaries Of Section 17(a) And The Duties Imposed Thereunder*

The first inquiry in *Cort* is whether the plaintiff is " 'one of the class for whose *especial* benefit the statute was enacted' . . . that is, does the statute create a federal right in favor of the plaintiff?" 422 U.S. at 78. The inquiry is really a formulation of the principal element of the classic statutory tort doctrine. The other element is a breach of duty to the damage of the intended beneficiary of the statute. (The legal duty owed by Touche Ross will be discussed *infra* at 30-31.)

As is apparent, this first consideration is more than a relevant factor—it is the threshold determination from

which the remedy flows unless the court concludes it must be denied by reason of the other three considerations.

That customers of brokers are the intended beneficiaries of Section 17(a) cannot be denied. In the words of the Court of Appeals, "[t]he language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which Weis' customers are members of a class peculiarly protected by section 17." (A. 196).

As in effect in 1972, Section 17(a) required a broker-dealer such as Weis to "make such reports, as the [Securities and Exchange] Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for *the protection of investors.*" (emphasis added).[25]

Pursuant to this provision, the SEC adopted Rule 17a-5, requiring broker-dealers to submit certain reports of their financial condition to the SEC at least annually on a Form X-17A-5. The form contains a detailed financial questionnaire as to, *inter alia,* customers' security accounts, the broker's trading, investment, and subordinated accounts, and the broker's "net capital." Like Section 17(a) itself, the rule promulgated and the form required thereunder were devised to protect customers against the hazards of entrusting their securities to broker-dealers. Prior to the adoption of Rule 17a-5, the SEC emphasized that adoption of the rule would increase customers' protection against the risk involved in leaving their securities with broker-dealers.

[25] In *Borak* this Court explained the propriety of finding an implied right of action under Section 14(a) as follows:

> "While . . . [14a] makes no specific reference to a private right of action, among its chief purposes is 'the protection of investors' which certainly implies the availability of judicial relief where necessary to achieve that result." 377 U.S. at 432.

National Association of Securities Dealers, 12 S.E.C. 322, 339 n.9 (1942). Similarly, in 1957, when the SEC expanded the certification requirements for Section 17(a) reports, it reiterated that the "certification and reporting requirements constituted a valuable regulatory tool *for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.*" REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 24 (1971) (emphasis added, footnote omitted).[26]

As noted earlier,[27] the accounting profession itself has recognized that the customers of broker-dealers are the class intended to be protected by the Section 17(a) reports.

Unquestionably, the function of the various financial reports required to be prepared and certified by independent accountants[28] and filed with the SEC is to protect customers against losses which may be incurred by reason of a broker's insolvency.[29]

As noted by the Court of Appeals:

> "The function of this arsenal of financial reports [required under Rule 17a-5] is to protect the broker's customers. One of the main methods adopted by the SEC to shield customers is the net capital rule . . . .

[26] This subject is discussed more fully at pp. 8-11 *supra.*

[27] See p. 15 *supra.*

[28] The question raised by Touche Ross as to accountants' duties under Section 17(a) is discussed *infra* at 30-31.

[29] As the SEC has noted, "[c]ustomers do not open accounts with a broker relying on suit, judgment and execution to collect their claim—they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." *Guy D. Marianette,* 11 S.E.C. 967, 970-71 (1942).

> "The . . . 'principal purpose . . . [of the net capital rule] is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers.' Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967) . . . .
>
> "It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows." (A. 197-98).

It is undeniable then that customers of brokers are "the class for whose especial benefit [Section 17(a)] was enacted . . . ."—the "favored wards" of Section 17(a) in the words of the Court of Appeals. (A. 200). Touche Ross does not contend otherwise.

As noted earlier, *supra* at 11-16, in light of the explicit requirements of Rule 17a-5 and Form X-17A-5, and the pivotal role accountants play in the statutory scheme, there can be no question that Touche Ross owed a duty to Weis' customers under Section 17(a).

Yet, Touche Ross raises the novel contention here that it was not subject to any duty under Section 17(a) because only the rule thereunder, and not the statute itself, refers to accountants. Petitioner's Brief at 79-80.[30] Apparently,

[30] Touche Ross misplaces its reliance upon *Rothstein* v. *Seidman & Seidman*, 410 F. Supp. 244 (S.D.N.Y. 1976) and *In re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161 (C.D. Cal. 1976). In each of those cases the rule upon which the action was predicated made no mention whatsoever of accountants. Of course, the same can hardly be said about Rule 17a-5 here. Similarly, Touche Ross' reference to *Santa Fe Industries, Inc.* v.

(Footnote continued on next page)

Touche Ross has overlooked that, on numerous occasions and with respect to various statutes, this Court has held that rules properly promulgated by a government agency pursuant to a congressional enabling mandate "have the force of law." *See, e.g., Public Utilities Commission of California* v. *United States*, 355 U.S. 534, 542 (1958); *Standard Oil Co.* v. *Johnson*, 316 U.S. 481, 484 (1942). Such rules "supplement the statute" under which they were promulgated. *Accardi* v. *Shaughnessy*, 347 U.S. 260, 265 (1954). Indeed, as this Court noted specifically with respect to rules under the 1934 Act, such rules may provide "the basis for imposition of liability." *General Electric Co.* v. *Gilbert*, 429 U.S. 125, 141 (1976). In fact, Section 27 of the 1934 Act grants exclusive jurisdiction to the federal courts as to "*violations* of this title or *the rules and regulations thereunder*," and as to "all suits in equity and actions at law *brought to enforce any liability or duty created by* this title or *the rules and regulations thereunder* (emphasis added).

Accordingly, Touche Ross may not escape the duty imposed upon it by Section 17(a) and Rule 17a-5 thereunder and owed to the intended beneficiaries thereof.

(Footnote continued from preceding page)

Green, 430 U.S. 462 (1977), and *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), for the proposition that a statute controls the interpretation of a rule, and that the scope of the latter may not exceed the power granted by the former, is wholly inapposite here. Both *Santa Fe* and *Hochfelder* involved the question of whether a lower standard for liability may be imposed under a rule than would be available under the enabling statute. Rule 17a-5 does not broaden the standard of liability under Section 17(a); in fact, neither the section nor the rule refers to standards for liability. Rather, the rule merely effectuates the section's mandate, and is consistent with its purpose; and not even Touche Ross argues that, in promulgating the rule, the SEC exceeded the power congressionally delegated to it by the section.

2. *There Is No Indication That Congress Explicitly Considered Whether To Create Or Deny A Private Right Of Action Under Section 17(a) Or That Congress Implicitly Chose To Deny A Private Right Of Action*

Cort next inquires: "[I]s there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?" 422 U.S. at 78. As to this factor *Cort* noted:

> "[I]n situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling." *Cort* v. *Ash,* 422 U.S. at 82 (footnote omitted).

The Court of Appeals found no indication, either in the statute itself or its legislative history, of any congressional intent to create or deny a private right of action under Section 17(a). The Court further concluded that there was no indication that Congress implicitly chose to deny a private right of action. (A. 198).

Touche Ross argues, however, that a congressional intent to deny a private right of action to customers under Section 17(a) is found in the enactment of Section 18(a).

(a) *Nothing In Section 18(a) Or In Section 17(a), Or In The Legislative History Of Either Section, Or In The Overall Legislative Scheme Suggests That Congress Intended Section 18(a) To Be The Exclusive Remedy For Any Violations Of Section 17(a)*

Section 17(a) only covers reports and documents filed by broker-dealers, the financial security of which is important to their customers who have securities or cash on deposit with them. As demonstrated, pp. 21, 27-30 *supra,* the purpose of enacting Section 17(a) was the protection of investors in their capacity as customers. Section 18(a) on the other hand was enacted for the benefit of investors in their capacity as purchasers or sellers of securities, who are injured by reason of their reliance on false statements filed by corporate issuers under certain reporting sections such as 13(a) or 15(d).

Even in those situations where a broker is also an issuer, the possibility of a violation of Section 17(a) being covered by Section 18(a) is merely theoretical.[31] The documents upon which investors make investment decisions are such things as prospectuses or registration statements, and not Section 17(a) documents. A situation in which an investor purchased or sold stock of a broker-issuer in reliance upon false statements in a report filed pursuant to Section 17(a), at a price "affected by" that misstatement, is, if not wholly theoretical, surely aberrational.

Yet it is on this slender reed, this theoretical possibility, that Touche Ross and the dissent conclude that "section 18(a) expressly provides the *sole private remedy* which

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[31] Section 18(a) provides, in relevant part, that any person filing a false or misleading statement "shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement. . . ."

Congress intended to be available for a violation of Section 17(a). . . ." (A. 211) (emphasis added). No support for this proposition can be found in the legislative history of Section 17(a) or 18(a).

Significantly, the legislative history of Section 18(a) is barren of any reference to liability for the false and misleading reports of broker-dealers filed pursuant to Section 17(a).[32] However, Touche Ross makes the bold assertion that "the legislative history does reflect a congressional *understanding* that the express Section 18(a) remedy was to apply to misstatements in Section 17(a) reports. . . ." Petitioner's Brief at 47 (emphasis added). The sole "authority" for this conclusion is a statement by the President of the New York Stock Exchange submitted to the Senate and House committee considering the bill. *See* Petitioner's Brief at 37 n.18.

Putting aside the ambiguous nature of the passing reference to "persons transacting business in securities" in the statement itself, it is absurd to conclude that a statement submitted to Congress by a third party establishes Congress' understanding of legislation eventually enacted by it. As recently as in *Piper* this Court, questioning "the value of written statements received without comment by the committee and without cross-examination," stated:

> "Only last Term we indicated that similar materials in the legislative history of the 1934 Act were of limited value.
>
> 'Remarks of this kind made in the course of legislative debate or hearings other than by persons responsible for the preparation or the drafting of a bill are entitled to little weight.' *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 204 n.24 (1976)." 430 U.S. at 31 n.20.[33]

[32] The legislative discussion excerpted in the *amicus curiae* brief of the American Institute of Certified Public Accountants at 9-10 is singularly unilluminating. The context of that discussion was whether experts, as opposed to other persons, could be held liable under Section 18, and not whether Section 18 applied to broker-dealers' Section 17 reports.

In fact, the legislative history of Section 18(a) reflects that the concern underlying that section was not with *all* false or misleading reports, but only with such reports as are filed by *corporations,* that is, with reports which potentially could affect the price of a corporation's securities. (At the time, only individuals—not corporations—could be members of the Exchange.[34] Quite obviously, therefore, the concern expressed for corporations did not include broker-dealers.) The Senate Report, in an obvious reference to Section 18, states that it

> "provides that any person who unlawfully manipulates the price of a security, or who induced transactions in a security by means of false or misleading statements, or who makes a false or misleading statement in the report *of a corporation,* shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement." S. REP. No. 792, 73d Cong., 2d Sess. 13 (1934) (emphasis added).[35]

[33] To the extent that such statements are given any weight, the fact is that numerous such statements indicate that their authors did not regard Section 18 as covering statements by brokers. *See* note 35 *infra.*

[34] *See* C. Meyer, THE LAW OF STOCKBROKERS AND STOCK EXCHANGES 86 (1931).

[35] During the hearings, wherever the type of report covered by Section 18 was clearly identified, it was invariably identified as a report about "corporations." *Hearings Before the Senate Banking and Currency Committee on S. Res. 56 and S. Res. 97,* 73d Cong., 1st Sess. 6673, 6697, 7186, 7281, 7282 (1934).

Thus the legislative history of Section 18(a) does not provide any basis for concluding that Congress even considered that section's relationship to Section 17(a), much less that it intended Section 18(a) to have a preclusive effect upon Section 17(a) and thereby to deny a remedy to the very class of investors it sought to protect by Section 17(a).

As noted *supra* at 33, Sections 17(a) and 18(a) are addressed to and deal with investors in two different and distinct capacities or spheres. Moreover, the sections are designed to deal with or protect against two distinct types of wrongs. The customers of a broker are wronged when they lose their securities or cash by reason of having continued to entrust same to the broker who, despite serious financial reverses, continues in business for a period on the basis of certified, but false, Section 17(a) reports. On the other hand, purchasers or sellers of securities are wronged when they have been misled by the issuer's false or misleading reports or statements and, in reliance thereon, purchase or sell the issuer's security at a price affected by the false statement.

In view of the foregoing considerations—no legislative history suggesting a connection between Sections 17(a) and 18(a), distinct categories of investors intended to be protected, and separate wrongs intended to be prevented—the Court of Appeals correctly rejected Touche Ross' contention that Section 18(a) precludes the recognition of a right of action under Section 17(a). As the Court of Appeals stated:

> "Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. *We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.*" (A. 200) (emphasis added).

(b) *Nothing In Amtrak Or Barbour Suggests That A Private Right Of Action Should Not Be Implied Here*

As noted above, *Amtrak* and *Barbour* held that implication of a private right of action "must be consistent with the evident legislative intent and, of course, with the effectuation of the purposes intended to be served by the Act." 414 U.S. at 458; 421 U.S. at 418.

In each case the issue was whether a private right of action to sue to enforce provisions of an act could be implied where Congress had enacted a provision in the act specifically granting such right to a person other than plaintiff. In each case this Court found "evident legislative intent" to deny a private right of action, and also found that to imply such a right would be inconsistent with the effectuation of the purposes intended to be served by the Act.[36]

In *Amtrak* the issue was whether the Rail Passenger Service Act ("Amtrak Act") could be read to create a private right of action on behalf of railroad passengers to enforce compliance with the Act's provisions. The Act's single section authorizing suits to enforce duties and obligations, Section 307(a), specifically provided for a public cause of action to vindicate private rights, maintainable by the Attorney General, and a *private* cause of action "*explicitly limited* to 'a case involving a labor agreement.'" 414 U.S. at 457 (emphasis added). Not only did the Act contain

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[36] This latter consideration is the third of the four factors listed in *Cort* and will be discussed *infra* at 42.

an express remedy for the specific wrong sought to be addressed, *i.e.*, a private right of action to sue for enforcement, the legislative history indicated that Congress had actually considered and rejected allowing a broader class of private plaintiffs. *Id.* at 458-61. This Court thus concluded that "the legislators understood that § 307(a) as written would preclude private causes of action to enforce compliance with the Act, other than in the limited area of cases 'involving a labor agreement.'" *Id.* at 461. The Court also concluded that implying a private right of action in favor of passengers affected by the discontinuance of passenger trains would "completely undercut the efficient apparatus that Congress sought to provide for Amtrak to use in the 'paring of uneconomic routes.'" *Id.* at 463.[37]

Barbour presented a similar situation. The issue presented therein was whether customers of broker-dealers have an implied private right of action under SIPA to compel SIPC to discharge its obligations under the Act. SIPA contained a provision granting *to the SEC* the right to sue to compel SIPC to discharge its obligations under the Act.

[37] As the Court explained the situation:

"In § 404 of the Act, Congress provided an efficient means whereby Amtrak could eliminate uneconomic routes . . . without the necessity of submitting to the time-consuming proceedings of state regulatory bodies or the Interstate Commerce Commission that had been required before the Act's passage. If, however, § 307(a) were to be interpreted as permitting private lawsuits to prevent the discontinuance of passenger trains, then the only effect of the Act in this regard would have been to substitute the federal district courts for the state or federal administrative bodies formerly required to pass upon proposed discontinuances." 414 U.S. at 461-62 (footnotes omitted)

The Court went on to discuss the inordinate delays and dislocations that would result from multiple suits in the various district courts around the country. *Id.* at 463-64.

421 U.S. at 417-18. This Court's holding that no private right of enforcement could be implied was based on its analysis of the legislative intent and overall legislative scheme from which it concluded that "a private right of action under the SIPA would be consistent neither with the legislative intent, nor with the effectuation of the purposes it is intended to serve." *Id.* at 424.

An analysis of *Barbour* and the legislation in question is illuminating. In enacting SIPA and the section granting to the SEC a right of action to sue for enforcement, Congress obviously: identified the duty—SIPC's obligation to protect customers; considered the possible wrong to the class by reason of SIPC's alleged wrongful failure to exercise its obligations; and consciously fashioned a remedy to redress the wrong, by taking what might ordinarily be a private right and placing it in the hands of public officials in order to further the effectuation of SIPA's overall purpose.[38]

The obvious distinction between these decisions and the case at bar is that in each case a cause of action identical to that being sought by the plaintiffs by implication, *i.e.*, the right to sue for enforcement, was expressly provided for in the Act in favor of persons other than plaintiffs. Equally significant, in both *Amtrak* and *Barbour* a remedy was provided for wrongs to the protected class; indeed, one of the reasons for declining to imply a private right

[38] As the Court explained it, SIPC possesses singular expertise as to what actions to take to avoid failure of a brokerage firm and when to take such actions ("SIPC properly treats an application for the appointment of a receiver and liquidation of a brokerage firm as a last resort," 421 U.S. at 421); with few exceptions, merely filing an action predicated on allegations of financial security could prove fatal to a broker; and, in marked contrast to SIPC, "[a] customer . . . cannot be expected to consider, or have adequate information to consider, these public interests in timing his decision to apply to the courts." *Id.* at 422.

of action of enforcement was the belief that the public officials would more effectively insure enforcement to the general benefit of the protected class. A denial of a private right of action in this case, however, would leave the intended beneficiaries of the statute without a remedy for wrongs the statute was designed to protect against.

Touche Ross also contends that the doctrine of *expressio unius est exclusio alterius*—which was referred to in *Amtrak*—compels a finding that Congress intended Section 18(a) to be the sole remedy for violations of Section 17(a). Petitioner's Brief at 41-43. This argument suffers from the same infirmities as the arguments discussed above. As this Court noted in *Cort:*

> "In *Amtrak*, there was a private cause of action *provided* in favor of certain plaintiffs *concerning the particular provision at issue.* It was *in this context* that we referred to '[a] frequently stated principle of statutory construction . . . that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies.' 414 U.S., at 458. In addition, there was specific support in the legislative history of the Amtrak Act for the proposition that the statutory remedies were to be exclusive. *Id.*, at 458-461." 422 U.S. at 83 n.14 (emphasis added).

Beyond its erroneous assertion as to the applicability of the *expressio unius* maxim to the instant situation, Touche Ross contends that because of the existence of Section 18(a) there must be " 'clear contrary evidence of legislative intent' to create an implied Section 17(a) remedy . . . to overcome the application of the *expressio unius* doctrine . . . ." Petitioner's Brief at 43. This assertion is, of course, directly in conflict with this Court's teaching in

Cort that "in situations where it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private right of action . . . ." 422 U.S. at 82.

(c) *Nothing In Blue Chip Stamps Suggests That A Private Right Of Action Should Not Be Implied Here*

Touche Ross also contends that the implication of a private right of action under Section 17(a), in light of the existence of Section 18(a), would conflict with *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). Petitioner's Brief at 43-45. Touche Ross points to the conclusion reached by this Court in *Blue Chip Stamps,* that "[i]t would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for *comparable* express causes of action." 421 U.S. at 735-36 (emphasis added). However, that conclusion resulted from the following predicament: both Sections 10(b) and 18(a) of the 1934 Act were, on their face, addressed to the protection of purchasers or sellers of securities caused injury by reason of false or misleading statements; yet, Section 18(a) provided for an *express* right of action, whereas the right of action under Section 10(b) had been judicially *implied;* and notwithstanding that Section 18(a) contained a stringent purchaser-seller requirement, it was urged upon the Court that Section 10(b) should not. No such predicament is created by Section 17(a). It is simply not intended to protect purchasers or sellers of securities; it is intended to protect the customers of broker-dealers. Consequently, it simply *cannot* be said about Sections 17(a) and 18(a), as was said in *Blue Chip Stamps* about Sections 10(b) and 18(a), that those sections are "comparable". No "anom-

aly" is created by implying a right in favor of brokers' customers.

Touche Ross also argues that the Section 17(a) claims of Weis' customers "are exactly the kind of speculative and unreliable claims that *Blue Chip Stamps* held are, and should be, excluded by the purchaser-seller requirements." Petitioner's Brief at 48. This statement is false and the argument misleading. In *Blue Chip Stamps,* the Court expressed concern over speculative and unreliable claims based on oral testimony by persons who had neither purchased nor sold a security and who could falsely claim that they made an investment decision based on a particular statement. 421 U.S. at 742-46. No such problem or similar problem exists with customers' claims under Section 17(a).

As to the argument that the claims involve questions of what remedial action would have been taken if Touche Ross had not made false certifications, such questions regarding causation and proof thereof are commonplace in litigation and in no way "raise precisely the problem that *Blue Chip Stamps* says must be avoided." *See* Petitioner's Brief at 49.

3. *Recognition Of A Private Right Of Action Under Section 17(a) Is Consistent With The Underlying Purposes Of The 1934 Act, And Is Necessary To Effectuate The Purposes Of The Section*

The third factor to be considered with respect to whether a private right of action should be implied is whether it is "consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?" *Cort* v. *Ash,* 422 U.S. at 78.

No one seriously quarrels with the fact that implication of a private right of action on behalf of customers is consistent with the broad disclosure purposes of the 1934 Act in general and the customer protection provisions of Sections 8, 15 and 17 in particular. Moreover, it bears more than passing observation that recognition of a private right of action under Section 17(a) and Rule 17a-5 is entirely consistent with the underlying purposes of SIPA which was enacted "to provide greater protection for customers of registered brokers and dealers . . ."[39] and had as one of its principal purposes "a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss."[40] H.R. Rep. No. 91-1613, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5254, 5255.

Nevertheless, Touche Ross, in its one page analysis of the *Cort* factors, argues that this third factor is not met because "an implied right of action would not be consistent with the legislative scheme, since it would effectively abolish the purchaser-seller limitation that Congress placed on express damage remedies." Petitioner's Brief at 67.

This argument is deficient for reasons already discussed at pp. 33-37 *supra.* As noted earlier, the purpose of Section 17(a) is to protect investors *qua* customers, and an implied right for such investors would not abolish the purchaser-seller requirement for investors seeking relief *qua* investors in securities. This is not a situation wherein a plaintiff has a remedy under Section 18 but is seeking to use an implied

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[39] *See* S. Rep No. 1218, 91st Cong., 2d Sess. 1 (1970). *See generally SIPC* v. *Barbour,* 421 U.S. 412, 415 (1975).

[40] This was accomplished by amending Section 15(c)(3) of the 1934 Act, which on its face applied only to over-the-counter broker-dealers, to cover all broker-dealers; and by further amending that section, which conferred general rulemaking authority on the Commission, to specify that that authority extends to rules relating to the protection of customers' securities and credit balances. Section 15(c)(3) of the 1934 Act was amended by Section 7(d) of SIPA.

remedy to circumvent its requirements. As the Court of Appeals noted:

> "Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced *not* to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se." (A. 201)

It is the very fact that the express remedies of the Act are limited to purchasers and sellers, and thus do not provide relief to other persons protected by the Act, such as customers, that makes it appropriate to imply a private right of action on behalf of customers. In this respect the case is similar to *Allen* v. *State Board of Elections*, 393 U.S. 544 (1969).[41]

The weakness in Touche Ross' argument regarding this third *Cort* factor is further exposed by reference to the two decisions discussing this factor which Touche Ross contends are "controlling."

[41] *Allen* dealt with the Voting Rights Act of 1965, which required that any new state laws passed regarding voting rights would be subject to approval procedures prior to implementation. Although the Act did not provide for an express right of action on behalf of private citizens, the Act stated that "no person shall be denied the right to vote for failure to comply with [an unapproved state enactment]." Although the Act did not provide for an express right of action on behalf of private citizens, this Court cited *Borak* and stated that the Act's goals would be severely hampered if an action were not implied and the citizens had to depend on the Attorney General who had the power to bring action at his discretion. This Court implied a right of action since the purpose of the Act was to protect a class of citizens, and absent such right of action, such protection would be ineffectual.

In *Amtrak* the Court concluded that implying a private right of action in favor of passengers affected by the discontinuance of passenger trains would "completely undercut the efficient apparatus that Congress sought to provide for Amtrak to sue in the 'paring of uneconomic routes.'" 414 at 453.[42] Similarly, in *Barbour* the Court declined to imply a private right of action because "as in *Amtrak*, it is clear that the overall structure and purpose of the SIPC scheme are incompatible with such an implied right." 421 U.S. at 421.[43]

A review of the Court's application of this third factor in *Piper* is equally illuminating. There the Court concluded that awarding damages to an unsuccessful tender offeror would not necessarily redound to the direct benefit of the protected class—shareholders of the *target* corporation—and indeed might be to their detriment. As the Court explained, although a monetary award to the unsuccessful bidder would indirectly benefit the shareholders of the target corporation who had exchanged their shares for those of the unsuccessful bidder, a damage award against the successful bidder would be detrimental to the shareholders of the target corporation who had exchanged their shares for the stock of the successful bidder. 430 U.S. at 39.

Actually, implication of a private right of action under Section 17(a) would not only be consistent with the underlying purposes of the 1934 Act, but is necessary to effectuate the purpose of Section 17(a).

In discussing this third factor, *Cort* quotes *Borak* as follows: "'[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose,' *J. I. Case Co.* v. *Borak*, 377 U.S., at

[42] The discussion of this holding appears *supra* at 37-38.

[43] The discussion of this holding appears *supra* at 38-39.

433, in this instance the remedy sought would not aid the primary congressional goal." 422 U.S. at 84.

Touche Ross, however, contends that *Piper* "'adds a significant gloss'" to *Cort* in regard to the "necessity factor." Petitioner's Brief at 59 n.32. Quoting from *Piper* —but putting its own gloss on the quote by adding the word "only"—Touche Ross argues that "a remedy can be regarded as 'necessary' only 'where *congressional purposes are likely to be undermined* absent private enforcement' (emphasis added). 430 U.S. at 25." Petitioner's Brief at 60.

What Touche Ross is suggesting is that the necessity factor is such that a party must be denied a right of action if he is unable to establish that effectuation of the congressional goals is not possible without a private remedy, *notwithstanding* that he has established:

(a) that he is a member of the class for whose special benefit the statute was enacted;

(b) that the duty owed him under the statute has been breached by the defendant to his damage;

(c) that there are no indications of legislation intent to deny a private right of action; and

(d) that implication of a private right of action would be consistent with the legislative scheme and is necessary to effectuate congressional goals *e.g.*, would "aid" or "further" such goals or would be a "necessary supplement" to Commission action.

Such a test would require that this Court conclude that the congressional scheme is to fragile, so imperfect, presumably so ill planned, that the legislative purpose would fail without a private right of action.

Nothing this Court has said before or since *Piper* suggests such a stringent and unrealistic test and it is respectfully submitted that this Court did not create such a test in *Piper*. The phraseology that this Court has consistently employed is "necessary to effectuate" congessional goals or "necessary supplement" to SEC enforcement.[44] Indeed, in describing the issues before it, *Piper* stated:

> "Against this background we must consider whether § 14(e), which is entirely silent as to private remedies, permits this Court to read into the statute a damages remedy for unsuccessful tender offerors. To resolve that question we turn to the legislative history to discern the congressional purpose underlying the specific statutory prohibition in § 14(e). Once we identify the legislative purpose, we must then determine whether the creation by judicial interpretation of the implied cause of action asserted by Chris-Craft is necessary to effectuate Congress' goals." 430 U.S. at 26.

Piper never reached the necessity question because it found that the legislative purpose of Section 14(e) was to protect shareholders of target companies and not unsuccessful offerors.

As to *Piper's* use of phraseology including "undermined", the Court was referring to the reasoning in *Borak* and *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). That Touche Ross is forcing a too stringent interpretation on these words is clear from a review of the language actually used in *Borak* and *Superin-*

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[44] *See Borak*, 377 U.S. at 433, *Blue Chip Stamps*, 421 U.S. at 730 ("the Court's recognition in *J. I. Case Co.* v. *Borak* . . . that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'"); *Rondeau* v. *Mosince Paper Corp.*, 422 U.S. 49, 62 (1975) ("[W]e have not hesitated . . . to fashion private remedies for securities laws violations when to do so is . . . necessary for the protection of investors as a supplement to enforcement by the Securities and Exchange Commission.")

tendent of Insurance, and by the juxtaposition by Touche Ross of the word "only" with the quote from *Piper. See* Petitioner's Brief at 60.

In the instant case an implied right of action would serve as a necessary supplement to SEC action for much the same reasons as in *Borak.*[45] The Court of Appeals so found.[46]

Moreover, an implied right of action for violations of Section 17(a) would undoubtedly result in a necessary deterrent against further abuses by brokers' accountants.[47]

[45] This case and *Borak* have in common the fact that they both involve a right of action asserted under the statute on behalf of its clearly intended beneficiaries—the proper persons to fill the void created by the SEC's institutional limitations. In *Piper,* on the other hand, the right of action was asserted not by a member of the class the statute intended to protect but a member of the class it sought to regulate, and consequently the SEC's institutional limitations were not relevant, nor did they in and of themselves provide a reason for implying a remedy. As this Court there pointed out: "[I]nstitutional limitations *alone* do not lead to the conclusion that *any party interested* in a tender offer should have a cause of action for damages against a competing bidder." 430 U.S. at 41 (emphasis added, footnote omitted).

[46] The Court of Appeals further explained:

> "In its *amicus brief,* the SEC advises us that, in fiscal 1976, over 5000 brokers and dealers were registered with it; that each of the approximately 750 broker-dealers that are not members of self-regulating organizations must be audited annually, as must the 500 or so against whom complaints are lodged; and that this leaves the SEC able to examine each year the statements of only 5% of broker-dealers who are apparently untroubled members of self-regulatory organizations." (A. 199 n.12).

[47] Touche Ross suggests that deterrence is no more of a proper consideration in this case than it was in *Piper.* Petitioner's Brief at 60. However, in *Piper* the Court noted that (a) "a monetary remedy . . . would not redound to the direct benefit of the protected class" (shareholders of target companies) and would actually harm those shareholders who exchanged shares for the shares of the successful bidder, and (b) shareholders will "more likely . . . be prejudiced" because risk of damage awards might deter tender

(Footnote continued on next page)

There is ample documented evidence of the fact that "independent" public accountants have not in fact acted independently in certifying their clients' financial reports. Thus, for example, in the "Report on the Auditors of Wall Street," which was based on the examination under oath of scores of individuals engaged in brokerage accounting and on the analysis of over a thousand in-depth questionnaires, the authors bluntly conclude that:

> "The stated opinions of auditors contained on balance sheets of brokers prepared for customers to peruse have, in many instances, been deceptive, avoided essential footnotes, and have been aimed more at showing a purported good financial health of a client rather than a true financial condition consistent with the auditor's responsibility." *Appendix F of the Hearings of the House Subcommittee on Interstate and Foreign Commerce,* 92d Cong., 1st Sess. 1091 (1971).
>
> "By the end of our initial study, we could without hesitation conclude that far too much management influence pervaded the auditing function in the securities business. This element constitutes the greatest possible danger to the investing public, and the securities market place." *Id.* at 1092.

In light of the strong criticism already directed against a significant segment of the accounting profession for their failure to comply with their responsibilities under the securities laws, it can hardly be concluded that existing remedies have been adequate to ensure the full effectiveness of Section 17(a). In these circumstances, the neces-

(Footnote continued from preceding page)

offers. 430 U.S. at 39, 40. Here, on the other hand, the threat of Section 17(a) actions by brokers' customers against brokers' accountants can have only therapeutic virtues, and would in no way "prejudice" the intended beneficiaries of the statute's protection.

sity of recognizing a private right of action under Section 17(a) to promote full and accurate review and certification so that customers and regulatory agencies can act *before* financial loss occurs becomes compelling.

These additional reasons make it necessary that a private right of action under Section 17(a) against accountants be available to brokers' customers. Not only did the Court of Appeals correctly recognize the existence of such an action, it also pointed out that "[n]either SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost." (A. 199).[48]

4. *Enforcement Of Section 17(a) Is Properly A Matter Of Federal, Not State, Concern*

The fourth *Cort* factor requires a consideration of whether "the cause of action [is] one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." 422 U.S. at 78.

As previously demonstrated, pp. 8-11 *supra,* Section 17(a) and Rule 17a-5 constitute the cornerstone for the protection of investors who entrust their cash or securities to brokerage firms doing business on the national securities markets. Accountants who undertake to perform Section 17(a) obligations for brokerage firms do so with the knowledge that the very effectiveness of the federal regulatory system designed to protect these investors depends upon how the accountants perform their obligations. When the accountants seriously fail in their crucial duties (as Touche Ross did), the consequences can be national in scope and necessarily affect the federal regulatory system itself.

[48] *Cf. Wyandotte Transportation Co.* v. *United States,* 389 U.S. 191, 202 (1967) (noting that punishment of a wrong-doer is hardly a satisfactory remedy for a pecuniary injury).

Thus, an accountant's breach of its Section 17(a) duties is principally a matter of federal, and not merely of state, concern. As Congress explicated in Section 2 of the 1934 Act:

> "[T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . ."

The Court of Appeals recognized that "[t]here is no reason to believe that the remedy sought herein is one traditionally relegated to state law." (A. 200). Exclusive federal court jurisdiction is already provided by Section 27 of the 1934 Act for "all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder." And, as this Court has proclaimed, "where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done." *Bell* v. *Hood,* 327 U.S. 678, 684 (1946) (footnote omitted). Accordingly, it would be wholly appropriate to recognize a federal cause of action based on Section 17(a) itself.

Indeed, the recognition of such a right of action is more than appropriate; it is essential. The availability of state court remedies to brokerage firm customers against brokerage firm accountants may be more theoretical than real. The substantive standards and the privity requirements under state law can impede the vindication of customers' rights, *see, e.g., Ultramares* v. *Touche, Niven, Bailey & Smart,* 255 N.Y. 170 (1931), thus making state remedies inadequate to effectuate the congressional purpose underiying Section 17(a).

Moreover, the laws of the states are varied with respect to customers' rights against accountants. Consequently, for the sake of uniformity, a federal right of action under Section 17(a) should be recognized. For, as the Court of Appeals stated, "it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting." (A. 200). *See J. I. Case Co.* v. *Borak,* 377 U.S. at 434 ("[I]f the law of the State happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the Section [14(a)] might be frustrated."); *Bivens* v. *Six Unknown Federal Narcotics Agents,* 403 U.S. 388, 409 (1971) ("[T]here is very little to be gained from the standpoint of federalism by preserving different rules of liability for federal officers dependent on the State where the injury occurs.")

E. *Policy Considerations Do Not Militate Against Implying A Private Right Of Action Under Section 17(a)*

Touche Ross argues that apart from the question of whether a private right of action should be recognized under the standards set forth in *Cort* v. *Ash* and related cases, policy considerations "militate" against recognition of a private right of action in this case. Petitioner's Brief at 71-78. These ostensible policy considerations are, according to Touche Ross: (1) Congress, rather than the judiciary, should address this issue; (2) a private right of action would burden the federal courts with litigation that should be relegated to state courts; (3) the absence of the purchaser-seller requirement would increase the danger of vexatious litigation; and (4) the implication of a private right of action would give impetus to efforts to imply similar rights under different reporting provisions.

With respect to the first policy argument raised by Touche Ross, there is simply no reason why this case is any less suited for judicial determination than cases arising under Sections 10(b) and 14(a) of the 1934 Act or cases arising under the many other provisions of the securities laws which the lower courts have recognized as giving rise to implied actions.[49] The federal courts traditionally fashion remedies for violations of federally secured rights, particularly, where, as here, there is a general grant of authority to sue (Section 27). As stated in *Borak*:

> "It is for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded. 'And it is also well settled that where legal rights have been invaded, and a federal statute provides for a *general* right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' *Bell* v. *Hood,* 327 U.S. 678, 684 (1946)." 377 U.S. at 433 (emphasis added).

The claim that accountants will become insurers of the success of the entire regulatory scheme is specious. Peti-

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[49] *See Franklin National Bank* v. *L. B. Meadows & Co.,* 318 F. Supp. 1339, 1341-42 (E.D.N.Y. 1970). *See also Wilson* v. *First Houston Investment Corp.,* 566 F.2d 1235 (5th Cir.), *cert. pending,* 46 U.S.L.W. 3766 (June 7, 1978); *Lewis* v. *Transamerica Corp.,* 575 F.2d 237 (9th Cir.), *cert. granted,* 47 U.S.L.W. 3310 (Nov. 7, 1978); *Abrahamson* v. *Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978); *Dann* v. *Studebaker-Packard Corp.,* 288 F.2d 210 (6th Cir. 1961); *Goldstein* v. *Groesbeck,* 142 F.2d 422 (2d Cir.), *cert. denied,* 323 U.S. 737 (1944); *Hofmayer* v. *Dean Witter & Co. Inc.,* 459 F. Supp. 733 (N.D. Cal. 1978); *Kerber* v. *Kakos,* 383 F. Supp. 625 (N.D. Ill. 1974); *Kroese* v. *Crawford,* [1961-64 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,262 (S.D.N.Y. 1963); *Reader* v. *Hirsch & Co.,* 197 F. Supp. 111 (S.D.N.Y. 1961); *Hawkins* v. *Merrill, Lynch, Pierce, Fenner & Beane,* 85 F. Supp. 104 (W.D. Ark. 1949).

tioner's Brief at 73-74. If an auditor falsely certifies a broker's Section 17(a) report with a consequent loss to customers, the auditor will be held responsible because he is a primary wrongdoer.

Touche Ross' concern over the existence of liability in an indeterminate amount for an indeterminate time to an indeterminate class, is more imagined than real. The amount will always be measurable and concrete, and would normally be no greater than in class actions brought on behalf of purchasers and sellers against accountants who, for example, prepare and certify false registration statements. The time will be determined by general principles of limitation and the class will simply be the customers of the brokerage firm and those who sue on their behalf.

As to the second "consideration," the question of "burdening" the federal courts hardly comports with the principle that where suits are brought on behalf of federally protected parties for violation of federally established rights, federal courts should be alert to adjust their remedies so as to grant the necessary relief. *See, e.g., Santa Clara Pueblo* v. *Martinez,* 46 U.S.L.W. 4412 (May 15, 1978) (White, J., dissenting); *Bell* v. *Hood,* 327 U.S. 678, 684 (1946); *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282, 288 (1940). Moreover, although Touche Ross notes that between 1970 and 1977, 128 brokerage firms failed and were placed in SIPA liquidation, Touche Ross does not mention that this is only the first action SIPC has commenced against accountants arising from these liquidations.

Third, there is no reason to believe that the absence of the purchaser-seller requirement would present a problem of vexatious litigation by customers of bankrupt brokers. The customers who have actually lost cash or securities

in a failed brokerage house are an easily identifiable and ascertainable class, contrasted with the non-purchaser/non-seller investor who could falsely claim damage by reason of a purported decision not to buy or sell, the situation confronting this Court in *Blue Chip Stamps.* Moreover, the decision to institute suit to recover funds expended by SIPC is made by a corporation which is established by Congress, has a board of directors consisting of two designees of high level government officials and five presidential appointees, and is subject to extensive oversight by the SEC as well as to congressional scrutiny. The danger that it will institute frivolous actions is nonexistent. Moreover, since most claims of investors, including all the claims of small investors, are now paid by SIPC, there is little danger that the customers of insolvent broker-dealers will institute class action "strike" suits having little merit but, perhaps, some settlement value. All this is borne out by eight years of SIPA history.

Finally, finding an implied right for *customers* under Section 17(a) will set no precedent for implying a right of action for investors under the different reporting sections which, unlike Section 17(a), involve issuers and their purchaser-sellers. This is not a case such as those discussed in Petitioner's Brief at 36-37, 53, involving a statute, such as Section 13(a) which involves reporting by issuers or purchasers of stock.

II

The Court Of Appeals Correctly Held That SIPC Is Subrogated To Weis' Customers' Section 17(a) Right Of Action Against Touche Ross.

Upon Weis' liquidation and pursuant to SIPA, SIPC advanced funds to the Trustee for the satisfaction (within certain statutory limits) of the claims made against Weis' estate by Weis' customers. On the basis of the fundamental common law doctrine of equitable subrogation, SIPC succeeds to the rights which Weis' customers could have asserted against Touche Ross, the wrongdoer, had their claims not been satisfied.[50] Accordingly, having earlier held that Weis' customers have a right of action under Section 17(a) against Touche Ross, the Court of Appeals held that SIPC is subrogated to this Section 17(a) right of action because

> "'[T]he general rule is that upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss.' 31 N.Y. Jur., *Insurance* § 1620, at 510." (A. 202).[51]

[50] Of course, SIPC is subrogated only to the extent that the SIPC fund was depleted to satisfy the claims. To the extent customer claims exceeded the limits prescribed in SIPA, they were not satisfied from the SIPC fund.

[51] The doctrine has been described as follows:

> "Subrogation, an equitable doctrine taken from the civil law, is broad enough to include every instance in which one party pays a debt for which another is primarily answerable and which in equity and good conscience should have been discharged by the latter, so long as the payment was made either under compulsion or for the protection of some interest of the party making the payment, and in discharge of an existing liability." *Gerseta Corp.* v. *Equitable Trust Co.*, 241 N.Y. 418, 425 (1926).

The decision below accords with the view adopted in the only other case which has referred to the question of SIPC's subrogation rights. *SEC* v. *Albert & Maguire Securities Co.*, 560 F.2d 569, 574 (3d Cir. 1977) ("[U]pon payment to a customer, SIPC becomes subrogated to the customer's rights against third parties.")

Touche Ross contends, however, that SIPC has no such common law subrogation right because, as Touche Ross would have it, SIPC's "exclusive subrogation remedy" is the one provided in Section 6(f)(1) of SIPA.[52] Touche Ross surmises that this is what "Congress clearly intended," which serves as a prelude to Touche Ross' by now familiar *expressio unius* argument. Petitioner's Brief at 101.

Nothing in the SIPA statute or in its legislative history even suggests that Congress intended, either explicitly or implicitly, that SIPC's statutory subrogation right would be its sole and preclusive subrogation remedy. In fact, the statute itself indicates that Congress intended just the opposite. Thus, Section 2 of SIPA provides:

> "Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 . . . apply

[52] Section 6(f)(1) of SIPA provides:

> "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section."

Touche Ross asserts that under this section SIPC is subrogated only to customer "claims" (but not causes of action) and only against Weis' estate (but not against third parties such as accountants), and that the Court of Appeals majority so "held". Petitioner's Brief at 100. In point of fact, the Court of Appeals merely noted, as was not contested below, that the section applies to claims *against the debtor's estate* (A. 201-02). The question of whether the word "claims" excludes causes of action was not even raised, much less decided, below.

as if this act constituted an amendment to, and was included as a section of, such Act."

And the 1934 Act, into which SIPA is thus incorporated, provides in Section 28(a):

"The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity. . . ."

Accordingly, the subrogation right in Section 6(f)(1) of SIPA was made available to SIPC *in addition to*, and not in abrogation of, SIPC's common law subrogation rights.

Moreover, Section 6(f)(1) must, of course, be viewed in the context in which it appears. It is a subsection of Section 6 which is headed "Liquidation Proceedings". As the Court of Appeals recognized:

"Section 78fff [Section 6 of SIPA] is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section." (A. 202).

In direct contrast to Section 6, no comprehensive scheme is contained in SIPA with respect to customer rights *outside* the context of liquidation proceedings. Consequently, there was no need to define by statute the subrogation right to which SIPC would be entitled under the common law. Not even Touche Ross suggests that the common law right of liquidated brokers' customers to sue third parties is abrogated by SIPA. In fact, Section 6(g) recognizes that customers may have common law rights against third parties which are assignable to the trustee in liquidation. *See SEC* v. *Albert & Maguire Securities Co.*, 560 F.2d at 574. Just as the common law right of customers to sue third

parties is preserved by SIPA, SIPC's common law subrogation right is also preserved.

The flaw in Touche Ross' *expressio unius* contention is that it is predicated on the notion that, when Congress fixes by statute a particular right, its actual intention is to deny other equitable and common law rights. However, as this Court has pointed out, "the legislative grant of a new right does not ordinarily cut off or preclude other non-statutory rights in the absence of clear language to that effect." *Federal Marine Terminals, Inc.* v. *Burnside Shipping Co.*, 394 U.S. 404, 412 (1969).

Touche Ross' contention also ignores that:

"However well these rules [*expressio unius* and *ejusdem generis*] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350 (1943) (footnote omitted).

The "generally expressed legislative policy" here is to maximize SIPC's recovery of the funds it expends in the course of broker-dealer liquidation. Thus, for example, Section 6(c)(2)(B)(i) of SIPA provides:

[*T*]*here shall be repaid to SIPC, in priority to all other claims payable from such single and separate fund,* the amount of all advances made by SIPC to the trustee to permit the completion of open contractual commitments . . . ." (emphasis added).

Similarly, Section 6(c)(2)(B)(ii) of SIPA provides:

> "[A]ll costs and expenses specified in clauses (1) and (2) of section 64a of the Bankruptcy Act shall be paid from such single and separate fund in priority to the claims of such single and separate class of creditors, and *any moneys advanced by SIPC for such costs and expenses shall be recouped as such . . . .*" (emphasis added).

And of course, Section 6(f)(1) itself, far from abrogating SIPC's common law subrogation right, is yet another example of Congress' concern that SIPC recoup any losses it can.

Touche Ross suggests, however, that "the result of permitting SIPC to sue as 'subrogee' would be to transfer from SIPC . . . to a third party such as Touche Ross the burden of providing the financial protection to customers that Congress specifically created SIPC in order to provide." Petitioner's Brief at 105. This statement represents a callous denial of the fact that the burden of providing customer protection is squarely placed first and foremost on accountants such as Touche Ross because the very efficacy of the "early warning system" depends upon their performance of their Section 17(a) obligations. See p. 16 *supra*. This was so long before SIPC was created, and has remained so since. To infer that by enacting SIPA Congress relieved accountants of the legal effect of the breach of their pre-existing duty is simply ludicrous. As the Court of Appeals recognized, "it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC . . . ." (A. 202).

Touche Ross also asserts that permitting SIPC to sue as subrogee makes the "holding with respect to SIPC's entitlement to sue in its own right illusory" because, as

Touche Ross would have it, Congress intended to protect only customers, and subrogating SIPC to their claims benefits only SIPC. Petitioner's Brief at 104. However, even if the Court of Appeals' statement that it did "not reach" the question of SIPC's own right to sue were a "holding" (A. 201, n.13),[53] it hardly would refute the fact that by SIPA Congress created a financial mechanism (SIPC) for the protection of customers in the event the first line of defense (financial responsibility) should fail. It wholly comports with the congressional intent to create this mechanism that it remain available to the fullest extent possible to its intended beneficiaries (brokers' customers), and that it be replenished by those who might defeat the first line of defense (brokers' accountants). In addition, while Section 4(h) of SIPA authorizes a billion dollar line of credit from the federal Treasury to SIPC, Congress was concerned that the exposure of such United States funds be avoided.[54] The impact of such a borrowing would be felt not only by the members of SIPC but also by the investing public on whose transactions special assessments could be levied as part of the necessary plan to repay the borrowed funds. Finally, the importance of the amendment of Section 15(c)(3) of the 1934 Act by Section 7(d) of SIPA should be noted. The amendment broadened the SEC's powers as to financial responsibility rules, and required that such rules provide for the maintenance of

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[53] This is one of the issues raised in SIPC's conditional cross-petition for certiorari (No. 78-526), which is still *sub judice*. In its response to that petition, Touche Ross stated that it did not oppose the petition.

[54] This concern is reflected in testimony given at the hearings held in connection with the enactment of SIPA. *Hearings Before the Subcommittee On Commerce and Finance of the Committee On Interstate and Foreign Commerce on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, and H.R. 18458*, 91st Cong., 2d Sess. 344-47 (1970).

reserves for customer deposits and credit balances. Thus, the amendment both intensified the congressional concern for the protection of brokers' customers *and* expanded the protected class to include SIPC itself.

Conclusion

For the foregoing reasons, as well as those set forth in the Trustee's brief, the judgment of the Court of Appeals should be affirmed.

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APPENDIX

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Statutes and Rules

Securities Exchange Act of 1934

Section 27, 15 U.S.C. § 78aa:

"Jurisdiction of Offenses and Suits."

"Section 27. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts."

FOR ARGUMENT.

Supreme Court, U. S.
FILED
MAR 20 1979
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In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

—*v.*—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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Thayer, *Public Wrong and Private Action,* 27 HARV. L. REV. 317 (1914) 21

Weinstein, *A Time of Travail and Challenge,* 44 CPA J. 29 (Dec. 1974) 30

Miscellaneous:

SEC Accounting Series Release No. 81 [1958], *reprinted in* 5 FED. SEC. L. REP. (CCH) § 72,103. 25

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,
Petitioner,

—*v.*—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

PRELIMINARY STATEMENT

The arguments set forth in the separate briefs of the Trustee and SIPC[1] to support the erroneous decision of the Court of Appeals majority simply do not accord with the language, structure and purposes of the 1934 Act, with the legislative history, or with the controlling authorities. Those arguments—which are a hodgepodge of overbroad generalizations about the purported role of the judiciary in effectuating Congressional purposes, erroneous assump-

[1] As used herein, "Tr. Br." refers to the Trustee's brief, "SIPC Br." to SIPC's brief, and "T. R. Br." to Touche Ross' main brief.

tions and assertions concerning the statutory meaning and legislative intent, and misstated and misapplied authorities—would have this Court ignore the express provisions of a comprehensive statutory and regulatory scheme established by Congress over more than forty years, and to create judicially for the purported benefit of brokerage firm customers a different set of duties and remedies that Congress itself never thought necessary and chose not to adopt.

The arguments of the Trustee and SIPC must also be considered in light of the fact that, for all their talk about protecting the rights of brokerage firm customers, the real beneficiary of the new duties and remedies that they would have this Court create is not the customers at all, but rather SIPC itself. The underlying premise of the arguments of the Trustee and SIPC is that brokerage firm customers are the "especial beneficiaries" of Section 17(a) and that an implied private right of action therefore should be created for the protection of those customers. While it is demonstrated hereinafter that that premise is erroneous, in any event neither the Trustee nor SIPC is such a customer, and both the Trustee and SIPC admit that ordinarily the only plaintiff capable of asserting any substantial Section 17(a) claims in a case of this sort is SIPC itself (especially since SIPC coverage for customer losses was increased by the 1978 amendments to SIPA), rather than any customer (Tr. Br. 48-49; SIPC Br. 55). In other words, the implication of a Section 17(a) remedy would not benefit the customers, but instead would benefit the entity (SIPC) that Congress created to provide financial protection to the customers, by permitting that entity to avoid the costs of providing that protection.

ARGUMENT

I

The Trustee And SIPC Err In Arguing That Section 17(a) Creates An Implied Private Right Of Action For Damages For Misstatements In Section 17(a) Reports

The Trustee and SIPC argue that the express remedy provided in Section 18(a) for misstatements in reports required by the 1934 Act is "not pertinent" to Section 17(a) reports, and therefore *National Railroad Passenger Corp.* v. *National Ass'n of Railroad Passengers ("Amtrak")*, 414 U.S. 453 (1974), *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975), and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), are inapplicable here; that Section 27 of the 1934 Act and the "statutory tort" doctrine require implication of a private right of action for violation of Section 17(a) because brokerage firm customers are the "especial beneficiaries" thereof; that such an implied private right of action is "necessary"; and that the criteria articulated in *Cort* v. *Ash*, 422 U.S. 66 (1975), are satisfied.

However, as demonstrated hereinafter, those arguments are erroneous and must be rejected. Section 18(a) plainly is applicable to Section 17(a) reports and reflects a Congressional intent that brokerage firm customers are not to derive substantive legal rights or remedies from the reporting requirements of Section 17(a). Moreover, the language and legislative history of Section 17(a) simply do not support the contention that Congress, in enacting Section 17(a), was particularly concerned with such customers, as distinguished from the purchasers and sellers referred to in Section 18(a), or that it intended Section 17(a) for the "especial benefit" of the customers.

Consequently, *Amtrak, Barbour* and *Blue Chip Stamps* are the controlling decisions, and the Trustee and SIPC err in purporting to distinguish them. They also rely improperly on Section 27 and the "statutory tort" theory, which not only do not provide the appropriate analysis, but also establish requirements that cannot be satisfied here. The Trustee and SIPC further err in arguing that an implied right of action under Section 17(a) is "necessary", because they overlook the many other "protections" already provided for brokerage firm customers, as well as the explicit Congressional recognition in enacting SIPA that there is no federally-created private damage remedy in the 1934 Act for customer losses resulting from brokerage firm failure, and that SIPC (rather than such a private damage remedy) was being created to fill that void; because they overstate the importance of the Section 17(a) reports involved here; and because they misstate the scope of the appropriate state law remedies. Finally, the Trustee and SIPC err in their purported *Cort* v. *Ash* analysis.

A. The Trustee And SIPC Err In Contending That Section 18(a) Is Not Pertinent To Section 17(a), And That *Amtrak, Barbour* And *Blue Chip Stamps* Therefore Are Inapplicable.

1. SECTION 18(a) IS PERTINENT HERE.—The Trustee and SIPC seek to avoid the obviously chilling effect of Section 18(a) on their claim of an implied private right of action under Section 17(a) by asserting the untenable proposition that Section 18(a) is "not pertinent" to Section 17(a) and is not "a material consideration" (Tr. Br. 39; SIPC Br. 21, *see also* 33-37). Their argument is that (i) Section 17(a) and Section 18(a) address "different and separable classes of persons and interests" or different

so-called "spheres" (Tr. Br. 39; SIPC Br. 21); (ii) Section 18(a) is addressed to investors "in their capacity *as traders", i.e.,* to a so-called "transactional sphere" (*id.*), whereas Section 17(a) is addressed to investors "in their capacity *as customers* who must entrust their cash or securities to broker-dealers", *i.e.,* to a so-called "bailment sphere" (Tr. Br. 40; SIPC Br. 21); and (iii) since brokerage firm customers are not "traders" (*i.e.,* purchasers or sellers of securities), Section 18(a) is not pertinent to them and a remedy should be implied for their benefit under Section 17(a) itself. The argument is totally without merit and must be rejected.

The contention of the Trustee and SIPC that Section 18(a) is "not pertinent" to Section 17(a) is so clearly erroneous as to be frivolous. Section 18(a) simply cannot be read as inapplicable to Section 17(a), in light of the express requirement of Section 17(a) that broker-dealers shall "make reports" and the express remedy of Section 18(a) for misleading statements in "any . . . report". That fact is inescapable and is uniformly recognized by the Court of Appeals majority, Judge Mulligan's dissent, the District Court, other decisions and the legislative history (*see* T. R. Br. 36-37).[2]

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[2] SIPC errs in contending that the legislative history of Section 18(a) does not reflect a Congressional understanding that Section 18(a) is applicable to misstatements in Section 17(a) reports (SIPC Br. 34-36). SIPC overlooks the statement of Senator Fletcher that Section 18(a) "imposes civil liability for false or misleading statements in any of the reports or records required under this act" (*see* T. R. Br. 38 n.18). Moreover, with respect to the written statement submitted to both the Senate and House committees by Richard Whitney, President of the New York Stock Exchange, which expressly refers to Section 18(a) liability for misstatements in reports required of "persons transacting business in securities" (*see id.*), Mr. Whitney testified at length concerning his views and was extensively cross-examined. *See Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before the Senate Comm. on Banking & Currency,* 73d Cong., 2d Sess. 6582, 6600, 6657, 6709, 6779, 6844, 6870, 7211 (1934); *Hearings on H.R. 7852 and H.R. 8720 Before the*

It is also specious for the Trustee and SIPC to contend that the purpose of Section 18(a) simply is "to define the elements of a cause of action for . . . . *traders* [*i.e.*, purchasers and sellers] in the stock of listed corporations" (Tr. Br. 39; *see also* SIPC Br. 33). Section 18 is entitled "Liability for Misleading Statements" (instead of, for example, "Rights of Traders" or "Rights of Purchasers and Sellers"), thereby plainly demonstrating that the Congressional intention in Section 18(a) was not simply to define the rights of so-called "traders", but to delineate the full scope of liability for misstatements in required reports.[3] By omitting from Section 18(a) any substantive rights for brokerage firm customers who are unable to satisfy the purchaser-seller requirement, Congress demonstrated an intention that customers are to derive no "legal rights" from the reporting provisions of Section 17(a).

The basic premise of the Trustee and SIPC that in enacting Section 17(a) Congress intended to protect investors in their role as "customers" as distinguished from investors in their role as so-called "traders", and thus to deal with a so-called "bailment sphere" as distinguished

House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 151, 178, 213, 287, 723 (1934). Consequently, SIPC does not advance its contention by noting the reference in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 31 (1977), to the "limited value" of "written statements received *without comment by the committee and without cross-examination*" (emphasis added) (*see* SIPC Br. 34). *Cf. Amtrak, supra*, 414 U.S. at 459-460 (weight given to letter sent by Secretary of Transportation to subcommittee chairman).

[3] That Congress always understood Section 18(a) to be applicable to reports filed by broker-dealers concerning their financial condition, and not only to reports of corporate issuers of securities (as is contended at SIPC Br. 35), is evidenced by the fact that when Congress enacted Section 8 of SIPA, 15 U.S.C. § 78hhh (1970), requiring broker-dealers to file reports of their financial condition and other matters for purposes of computing SIPC assessments, it saw a need for expressly exempting those reports (which are not the reports here involved) from the scope of Section 18(a).

from a so-called "transactional sphere", is an imaginary construct that has never been urged or accepted anywhere before, and is both totally unsupported by any authority and contradicted by the pertinent legislative history. Nothing in the language of Section 17(a), or in any decision, suggests the distinction urged by the Trustee and SIPC, and the attempt of the Trustee and SIPC arbitrarily to compartmentalize the reporting provisions of the 1934 Act into different purported "spheres" conflicts with the fact that many of the reporting provisions are intended for the benefit of various different types of investors, *see, e.g.*, *GAF Corp.* v. *Milstein*, 453 F.2d 709, 713 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972) (Section 13(d)), yet only purchasers and sellers have any remedy for misleading statements in such reports (*see* T. R. Br. 51-54). Moreover, the meager citations to the legislative history of the 1934 Act upon which the Trustee and SIPC rely (*see* Tr. Br. 6, 29) neither refer to Section 17(a) specifically nor support the premise that Congress enacted Section 17(a) for the especial benefit of brokerage firm customers, as opposed to purchasers and sellers. The portion of the House report cited by the Trustee and SIPC simply discusses, without mentioning Section 17(a), the evils of unnecessary, unwise and destructive speculation in stocks that resulted in "mad booms and terrible depressions". H.R. REP. NO. 1383, 73d Cong., 2d Sess. 3 (1934). Similarly, the portion of the Senate report cited by the Trustee and SIPC does not refer to Section 17(a) and relates only to the dangers resulting from an "undue volume of brokers' loans" that provided "excessive credit for speculation" and imperiled margin *traders* and the banking system. S. REP. NO. 1455, 73d Cong., 2d Sess. 12-15 (1934). Significantly, the Trustee and SIPC omit any reference to another Senate report that, in discussing the actual Congressional intention in enacting Section

17(a), mentions only the need for brokers to maintain "adequate records of transactions" so the SEC would be "able to obtain evidence rapidly in any case where *fluctuations in the price of a security indicate that manipulation may be in progress*" (emphasis added), and that thereby makes clear Congress' concern underlying Section 17(a) to protect not brokerage firm customers (as the Trustee and SIPC argue), but rather the very purchasers and sellers (to whom the Trustee and SIPC refer as "traders" in the "transactional sphere") who concededly are the beneficiaries of the express remedy of Section 18(a).[4] S. REP. NO. 792, 73d Cong., 2d Sess. 13 (1934).[5]

[4] Although Congress' express concern in enacting Section 17(a) clearly was not the protection of brokerage firm customers, the SEC has relied since 1942 on the rule-making authority provided by Section 17(a) to require broker-dealer reports that are intended, at least in part, to improve safeguards afforded to such customers. However, even in that respect, the primary purpose of the Section 17(a) reports has been to provide one element of a reporting and monitoring system that attempts to prevent brokerage firm insolvencies, and not to provide any scheme of private damage remedies for recovery of losses after insolvency has occurred (*see* T. R. Br. 21-23, 60-64).

[5] Even if it were assumed, as the Trustee and SIPC contend, that Section 17(a) is concerned uniquely with the protection of customers, that Section 18(a) does not and was not intended to deal with that concern, and that there is only a "merely theoretical" possibility that the Section 18(a) remedy will be available for misleading statements in Section 17(a) reports (SIPC Br. 33; *cf.* Tr. Br. 40; *but see* T. R. Br. 36 n.17, 64 n.39), Section 18(a) nevertheless still is pertinent. The fact that Congress *contemporaneously* provided in Section 18(a) a remedy to purchasers and sellers for misleading reports, but failed to provide therein any similar remedy to customers, demonstrates that Congress did not intend that the customers have a damage remedy (*see* T. R. Brief 57-58). *See T. I. M. E., Inc.* v. *United States,* 359 U.S. 464 (1959) (the enactment of an express remedy with regard to certain provisions of a statute requires an inference that the omission of a similar remedy for other comparable provisions was intentional); *cf. Cort* v. *Ash,* 422 U.S. 66, 82-83 n.14 (1975) (such an inference is not required where, unlike the situation here, the statutory provision under which a remedy is sought to be implied is "of much earlier origin" than the statutory provisions for which an express remedy is provided).

2. *Amtrak* AND *Barbour* ARE CONTROLLING DECISIONS HERE.—The Trustee and SIPC argue that Section 18(a) is "not pertinent" to Section 17(a) reports as part of their attempt to distinguish away this Court's otherwise clearly controlling decisions in *Amtrak* and *Securities Investor Protection Corp.* v. *Barbour, supra* (*see* SIPC Br. 37-41; Tr. Br. 42-45). Of course, since Section 18(a) is so clearly applicable to Section 17(a) reports, and since the Trustee and SIPC err in arguing to the contrary, their purported basis for distinguishing *Amtrak* and *Barbour* simply does not exist. As another part of their attempt to fabricate a distinction, the Trustee and SIPC talk at length about their unsupported assumptions concerning "evident legislative intent" and the "overall legislative scheme", but in so doing they overlook the central teaching of both *Amtrak* and *Barbour.* Those decisions recognize that Congressional enactment of a limited express remedy for violation of a particular statutory provision is probative and compelling evidence of a legislative intent to preclude a broader implied remedy; that such evidence derived from the statutory structure is determinative (under the doctrine, *expressio unius est exclusio alterius*) in the absence of "clear contrary evidence" of legislative intent; and that to imply such a broader implied remedy absent the requisite "clear contrary evidence" would be inconsistent with the legislative scheme (*see* T. R. Br. 40-43). In addition, as in *Amtrak* and *Barbour,* acceptance of the theory urged by the Trustee and SIPC would undermine the statutory purposes.

The Trustee and SIPC err in arguing that the "clear contrary evidence of legislative intent" requirement of *Amtrak* and *Barbour* "conflicts" with the statement in *Cort* v. *Ash, supra,* 422 U.S. at 82, that where "it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private right of action, although an explicit purpose to *deny* such

cause of action would be controlling" (*see* SIPC Br. 40-41). That statement was addressed to a situation where (unlike *Amtrak*, which *Cort* v. *Ash* expressly distinguished, and *Barbour*) no express remedy whatsoever was provided for violation of the pertinent statutory provision and therefore nothing in the statutory structure itself reflected an intention to deny an implied remedy. This point is emphasized in *Barbour* where, even though the "primary [Congressional] purpose" in enacting SIPA was "the protection of investors", this Court, in refusing to imply a remedy for such investors, did not require an affirmative showing from the legislative history of a Congressional intention to deny an implied right of action and no such legislative history was cited. Instead, *Barbour* simply reiterated the "clear contrary evidence" requirement of *Amtrak* (*i.e.*, the requirement of explicit evidence of Congressional intention to *create* an implied right of action) and found that it was not satisfied because "there is no extrinsic evidence that Congress intended to allow [such] an action". 421 U.S. at 419-421.

The Trustee and SIPC also would distinguish *Amtrak* and *Barbour* on the purported ground that, although the particular plaintiffs there concededly were denied the remedies they sought, the "protected classes" in general were not denied protection since enforcement still could be sought by the Attorney General (*Amtrak*) and the SEC (*Barbour*), whereas here denial of an implied Section 17(a) remedy purportedly would be inconsistent with the legislative intent because it "would leave the intended beneficiaries of the statute without a remedy for wrongs the statute was designed to protect against" (SIPC Br. 39-40). However, even assuming that Congress did enact Section 17(a) to protect brokerage firm customers (which it did not, *see* pp. 6-8, *supra*), the purported distinction is

unpersuasive. The refusal to imply a Section 17(a) remedy will not deprive customers generally of protection, for they already have many "protections", including the preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970), both as part of the monitoring system and as a source of funds to pay customer losses, the deterrent effect of criminal and injunctive proceedings, and the availability of state law remedies (*see* T. R. Br. 56, 60-63; *see also* pp. 24-28, *infra*, concerning the lack of "necessity" for an implied right in light of such existing protections). Those "protections", rather than any implied private right of action for damages under Section 17(a), are comparable to the means of protection found to have been intended by Congress in *Amtrak* and *Barbour*. *See also* S. REP. NO. 792, 73d Cong., 2d Sess. 13 (1934) (in subdivision entitled "Administrative Machinery", dealing with the SEC's authority to take "disciplinary action short of criminal or civil penalties", Section 17 discussed as a means to provide the SEC with information to enable it to fulfill its "responsibility for investigating violations of the act").

In enacting SIPA in 1970, Congress explicitly recognized the existence of such "protections" for brokerage firm customers. *See* H.R. REP. NO. 91-1613, 91st Cong., 2d Sess., *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5254, 5256 ("There are some safeguards, however, on both the State and Federal levels as well as in industry imposed regulations"); *Hearings Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, Security Investor Protection,* 91st Cong., 2d Sess. 150 (1970) (statement of SEC chairman Hamer H. Budge). Moreover, in creating SIPC to provide funds to pay customer losses, Congress explicitly stated its understanding that no federally-created private damage remedy under any section of the 1934 Act (*e.g.*, Section

17(a)) was available to compensate against such losses. As the Senate report on SIPA pointed out,

> "Apart from the voluntary trust funds, *there is no protection presently available under existing securities laws for the investor whose broker goes bankrupt.* The Securities Act of 1933 requires that investors have adequate information to exercise sound judgment concerning the securities they purchase; and the Securities Exchange Act of 1934 insures that they will not be victimized by fraudulent, manipulative, or deceptive selling schemes. But *neither statute prevents the investor from losing his entire investment if his broker fails* because of operational and, ultimately, financial difficulties" (emphasis added). S. REP. NO. 91-1218, 91st Cong., 2d Sess. 3 (1970).

Therefore, to the extent that it considered existing "protections" for customers to be inadequate, *see* H.R. REP. NO. 91-1613, *supra,* at 5256, Congress clearly "believed that it was filling a regulatory void" when it enacted SIPA and created SIPC (instead of a private damage remedy) to provide the additional financial protection to customers it believed necessary (*see* T. R. Br. 62 n.37). *International Brotherhood of Teamsters* v. *Daniel,* 99 S. Ct. 790, 802 (1979). *See* 116 CONG. REC. 40867 (1970) ("there still exists *a serious gap* in our securities laws which neither of [the 1933 Act and the 1934 Act] covers" (emphasis added)) (remarks of Sen. Muskie).

Implication here of a private right of action under Section 17(a) would create the serious potential for undermining significant statutory purposes, an effect held to be unacceptable in *Amtrak* and *Barbour.* One of the important purposes of SIPA was to impose upon SIPC, the SEC and the self-regulatory organizations such as the stock exchanges the duty of insuring the financial responsi-

bility of brokerage firms. For example, Section 9 of SIPA provides that "[t]he self-regulatory organization of which a member of SIPC is a member shall inspect or examine such member for compliance with applicable financial responsibility rules", and that "SIPC shall consult and cooperate with the self-regulatory organizations toward the end . . . that . . . examinations to ascertain whether members of SIPC are in compliance with applicable financial responsibility rules will be conducted by the self-regulatory organizations under appropriate standards". 15 U.S.C. §§78iii(c), 78iii(e) (1970). *See also* Section 6 of the 1934 Act, 15 U.S.C. §78f (each national securities exchange is "to enforce so far as within its powers compliance by its members, with the provisions of [the 1934 Act]"). And in *Barbour,* this Court pointed out that

> "Congress enacted the SIPA to . . . restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered brokers and dealers . . . . *The Act apportions responsibility for these tasks among the SEC, the securities industry self-regulatory organizations, and the SIPC.* . . . Congress imposed upon the SEC, the exchanges, and the self-regulatory organizations the obligation to report to the SIPC any situation that might call for its intervention" (emphasis added). 421 U.S. at 415-416, 425.

Of course, in that apportionment of responsibility, there is no mention of any role for, or duties imposed upon, independent accountants such as Touche Ross. However, the Trustee and SIPC, in arguing for the implication of a private right of action under Section 17(a), nevertheless assume the existence of just such a role and such duties, and proceed from there to magnify the responsibilities (and the concomitant risks and exposure to liability)

allegedly implicitly imposed upon accountants, and to minimize accordingly the responsibilities explicitly imposed upon the regulatory authorities such as SIPC. Thus, the thrust of the argument by the Trustee and SIPC is that the legislative scheme contemplates that the SEC, SIPC and the self-regulatory organizations are not themselves to perform virtually all of the inspection and monitoring duties statutorily imposed upon them, and that such duties are to be transferred by judicial implication to the accountants who are retained by a brokerage firm (*see* Tr. Br. 18-19, 33-35), an argument exemplified by SIPC's blatantly absurd assertion that the once-yearly "certifications [by accountants] of Section 17(a) reports are the *only* means through which the SEC and the self-regulatory organizations are assured that broker-dealers are not in violation of the net capital rule" (SIPC Br. 16).[6]

It would undermine the statutory purposes, and only encourage lack of diligence on the part of the regulatory authorities, to accept the view of the Trustee and SIPC that the once-a-year audits of brokerage firms are the *only* means to enforce financial responsibility rules, and that accountants therefore must be deemed responsible for all subsequent consequences of undetected weaknesses (*see also* T. R. Br. 74, 105). In this case, the regulatory authorities, obviously embarrassed by the failure of whatever inspection and monitoring they performed (or should have performed) to detect the illicit practices in which Weis engaged throughout virtually its entire 1973 fiscal year, seek a scapegoat and attempt to place all the blame on Touche Ross because of its failure to detect the alleged incipiency of such practices at the end of Weis' 1972 fiscal year (*see* A. 9 [¶12], A. 19-A. 21[¶31]). If Touche Ross

[6] The fact that the Trustee and SIPC overstate the importance of the once-a-year audits, and that the "early warning system" involves much more than those audits, is discussed at pp. 26-27, *infra*.

is to be held responsible for the fact that the regulatory authorities were unable properly to supervise Weis during an entire year subsequent to the audit, it is apparent that in future situations the regulatory authorities will feel no compelling need to be diligent or aggressive in their continuing responsibility to inspect broker-dealers, knowing that if any problems arise, they need only to blame the accountants for failing to discover on their previous once-a-year audit the alleged weaknesses that purportedly permitted the problems later to develop. At bottom, then, the theory of the Trustee and SIPC is that, despite Congress's express allocation of continuing duties to the regulatory authorities (including SIPC's duty ultimately to pay customer losses), they should be permitted to pass on those duties to accountants who agree to perform a once-a-year audit of a brokerage firm's Section 17(a) reports.[7] That result would be totally inconsistent with the statutory purposes.

3. *Blue Chip Stamps* ALSO CONTROLS HERE.—The Trustee and SIPC also improperly attempt to distinguish *Blue Chip Stamps* v. *Manor Drug Stores, supra,* which applied in the specific context of the 1934 Act the principle, recognized in *Amtrak* and *Barbour,* that it is improper to imply a remedy for a statutory violation that would be broader than the express remedy already provided in

[7] *Cf. Securities & Exchange Commission* v. *Arthur Young & Co.*, ___F.2d ___, [Current Binder] FED. SEC. L. REP. (CCH) ¶96,766 at 95,006-95,007 (9th Cir. Feb. 1, 1979)("To accept the SEC's position would go far toward making the accountant both an insurer of his client's honesty and an enforcement arm of the SEC. We can understand why the SEC wishes to so conscript accountants. Its frequently late arrival on the scene of fraud and violations of securities laws almost always suggests that had it been there earlier *with the accountant* it would have caught the scent of wrongdoing and, after an unrelenting hunt, bagged the game. What it cannot do, the thought goes, the accountant can and should. The difficulty with this is that Congress has not enacted the conscription bill that the SEC seeks to have us fashion and fix as an interpretive gloss on existing securities laws.")

the statute (SIPC Br. 41-42). They misconstrue, and therefore misapply here, this Court's statement in *Blue Chip Stamps* that it would be "anomalous" to expand the plaintiff class for a judicially implied cause of action beyond the bounds delineated by Congress "for *comparable* express causes of action" (emphasis added by SIPC). *Blue Chip Stamps* did not, as they circularly argue, find Sections 10(b) and 18(a) of the 1934 Act to be "comparable" because both were intended to provide remedies only to purchasers or sellers, for the very issue to be decided in *Blue Chip Stamps* was whether Section 10(b) did apply only to purchasers or sellers. Rather, Sections 10(b) and 18(a) were found to be "comparable" because they dealt with similar subject matter, and that finding was the premise for the Court's conclusion that the express purchaser-seller requirement of Section 18(a) must also apply to implied rights of action under Section 10(b). To imply a right of action under Section 17(a) broader than the express remedy under Section 18(a) would be even *more* "anomalous" than to imply such a broader right under Section 10(b). The express Section 18(a) remedy deals not with circumstances which are simply "comparable" to those dealt with by Section 17(a); it deals with precisely the same circumstances, *viz.*, misstatements in reports required to be filed under Section 17(a). Consequently, the *Blue Chip Stamps* principle is not distinguishable and precludes any implied private right of action under Section 17(a).

In response to Touche Ross' demonstration that this case involves the type of speculative claim that *Blue Chip Stamps* recognized should be precluded by the purchaser-seller requirement of Section 18(a) (T. R. Br. 48-50), the Trustee and SIPC offer only their own conclusory assertions that it is not so, coupled with the self-serving declaration that neither of them would commence a

"strike" suit (*see* SIPC Br. 42, 54-55; Tr. Br. 45-46). However, their own description of this case as "a private action to recover customer losses that *might have been* avoided by a proper audit" (emphasis added) (Tr. Br. 19) belies their denial that the claim asserted here necessarily is a speculative one. The administrative scheme established by the 1934 Act and SIPA permits the regulatory authorities (including the SEC, SIPC and the stock exchanges) a broad range of *possible* actions in attempting to deal with the problems of a brokerage firm that is in peril of financial collapse, but experience demonstrates the uncertainties involved and that the regulatory authorities will not necessarily succeed in averting a collapse even after timely notice of the peril. *See Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 421-422; *Hughes* v. *Dempsey-Tegeler & Co., Inc.,* 534 F.2d 156, 168-174 (9th Cir.), *cert. denied,* 429 U.S. 826 (1976). There simply is no way that the Trustee and SIPC here (or plaintiffs in any similar case) could offer any proof other than subjective, "uncorroborated oral evidence"—*i.e.,* surmise and conjecture—as to what the regulatory authorities *might* have been able to accomplish had Weis' Section 17(a) reports not been misleading, and their subjective version of what *might* have occurred necessarily would relate to "elements . . . totally unknown and unknowable to the defendant". *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 746.

The Trustee and SIPC also argue that "[t]his Court's decisions under Rule 10b-5 and the Williams Act have never suggested that Section 18 is the exclusive remedy for Exchange Act violations even where, as in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), the filing of a 'report' or 'document' was involved" (Tr. Br. 42), and that *Piper* involved "false statements in a registration statement" (Tr. Br. 21). While the argument is mis-

leading, because a registration statement is a document filed under the 1933 Act, not the 1934 Act, and because *Piper* involved misstatements in a variety of documents (*e.g.*, letters to shareholders and press releases) not filed under either the 1933 Act or the 1934 Act, the argument must also be rejected because of its more basic error. Even if it be assumed that remedies for violations of the *antifraud* and *proxy* provisions (the basic purpose of which is to insure that investors are furnished directly with adequate data in connection with their own investment and corporate voting activities) would not be precluded by Section 18(a) simply because the data also is filed with the SEC,[8] it does not follow that Section 18(a) does not set forth the exclusive remedy intended by Congress for violation of *reporting* provisions, such as Section 17(a) (the basic purpose of which is to provide information to the SEC and regulatory authorities—*see* T. R. Br. 23, 63-64).

B. The Trustee And SIPC Err In Their Reliance On Section 27 Of The 1934 Act And The "Statutory Tort" Theory.

In arguing for an implied right of action under Section 17(a), the Trustee and SIPC rely heavily on the jurisdictional grant in Section 27 of the 1934 Act and the

[8] Several district courts have held that the exclusive remedy in Section 18(a) for misstatements in documents filed with the SEC pursuant to the 1934 Act precludes any implied remedy for such misstatements under Section 10(b) and Rule 10b-5. *See, e.g., Ross* v. *A. H. Robins Co., Inc.*, [Current Binder] FED. SEC. L. REP. (CCH) ¶96,737 (S.D.N.Y. 1979); *Poller* v. *First Virginia Mortgage & Real Estate Investment Trust*, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,564 (E.D. Va. 1978); *Kulchok* v. *Government Employees Ins. Co.*, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,002 (D.D.C. 1977). *Cf. Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 752 n.15, where this Court reserved "the question of whether an implied action under §10(b) of the 1934 Act and Rule 10b-5 will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act".

"statutory tort" theory, which SIPC contends was incorporated into the analysis set forth in *Cort* v. *Ash, supra* (*see* Tr. Br. 25-38; SIPC Br. 20-25, 53). Although SIPC (but not the Trustee) also purports to set forth an analysis based upon *Cort* v. *Ash,* both the Trustee and SIPC appear to rely on Section 27 and the "statutory tort" theory independently of *Cort* v. *Ash.* However, their reliance is misplaced, because it fails to take into account such crucial criteria as (i) consistency of any implied right of action with the evident legislative intent and effectuation of the underlying statutory purposes (recognized in *Amtrak* and *Barbour,* and reiterated in *Cort* v. *Ash*), (ii) the "necessity" for an implied right of action (recognized in *Borak,* reiterated in *Cort* v. *Ash* and emphasized in *Piper*), and (iii) the appropriateness of state law remedies (recognized in *Cort* v. *Ash, supra,* and emphasized in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977), and *Piper* v. *Chris-Craft Industries, Inc., supra*). Moreover, Touche Ross does not, as the Trustee puts it (Tr. Br. 20, 39), "virtually concede" that the "statutory tort" theory and the cases purportedly articulating it, even if they were applicable, would require the implication of a private right of action under Section 17(a).

1. SECTION 27 DOES NOT REQUIRE THAT A PRIVATE RIGHT OF ACTION BE IMPLIED UNDER SECTION 17(a).—The Trustee and SIPC erroneously argue that a private right of action must be implied from Section 17(a) because Section 27 of the 1934 Act generally grants to the federal courts jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created" under the 1934 Act. 15 U.S.C. §78aa. Even the cases most heavily relied upon by the Trustee and SIPC do not hold, as they would have it, that by virtue of Section 27 *all* provisions of the 1934 Act *per se* give rise to implied private rights of action to redress violations

thereof. For example, even in *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432 (1964), which did rely on Section 27, this Court stated that an implied right of action was available because it was "necessary" in order to achieve the purposes of Section 14(a). *See* Comment, *Implying Private Causes of Action From Federal Statutes: Amtrak and Cort Apply the Brakes,* 17 B.C. INDUST. & COM. L. REV. 53, 56 and cases cited in n.32 (1975) (criticizing discussion in *Borak* of Section 27 and noting that "the Supreme Court itself has almost always interpreted *Borak* as standing for an alternative principle [of necessity], without giving mention to the section 27 holding"). Similarly, this Court recently stated in *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25, that its decisions hold only "that *in some circumstances* a private cause of action can be implied with respect to the 1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies", *viz.,* only in circumstances "where congressional purposes are likely to be undermined absent private enforcement" (emphasis added). *Accord, Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 477; *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 62-63 (1975). As pointed out in *Bell* v. *Hood,* 327 U.S. 678 (1946), a provision such as Section 27 only grants jurisdiction to determine *whether* an implied federal right of action exists. The reliance by the Trustee and SIPC (Tr. Br. 26; SIPC Br. 54) on *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282 (1940), also is misplaced, because "all that the *Deckert* case stands for . . . is that historic equity jurisprudence gives the federal courts very broad authority to grant relief that is ancillary to an action expressly created". 5 L. LOSS, SECURITIES REGULATION 2882 (2d ed. Supp. 1969) (also criticizing discussion in *Borak* of Section 27).

2. THE "STATUTORY TORT" THEORY IS INAPPOSITE HERE BECAUSE NO LEGAL RIGHTS OF BROKERAGE FIRM CUSTOMERS ARE INVADED BY REASON OF MISSTATEMENTS IN SECTION 17(a) REPORTS.—The Trustee and SIPC put great emphasis on a superficial and uncritical exposition of the purported "historical development" of the "statutory tort" theory, an exposition purportedly designed to establish the premise that—under "longstanding doctrine" said to originate "in English jurisprudence" going back to I COMYNS' DIGEST 248 (1762), as quoted in *Texas & Pacific Ry. Co.* v. *Rigsby,* 241 U.S. 33, 39 (1916)—the violation of a statute gives rise "in every case" to an implied right of action on behalf of persons for whose benefit it was enacted (SIPC Br. 22-23; *see also* Tr. Br. 25-30). The error of that simplistic approach both as a matter of history and of policy was demonstrated long ago. *See* 2 F. HARPER & F. JAMES, THE LAW OF TORTS 995 (1956) ("modern cases in this country make little use of the discredited reasoning"); Thayer, *Public Wrong and Private Action,* 27 HARV. L. REV. 317, 331-332 (1914); Note, *The Use of Criminal Statutes in the Creation of New Torts,* 48 COLUM. L. REV. 456, 457 and n.9 (1948). *See also* 5 L. LOSS, SECURITIES REGULATION, *supra,* at 2883-2885.[9] More significantly, the doctrine is limited by the

[9] As part of its exposition of the "historical development" of the implied rights doctrine, SIPC states that "*Hawkins* v. *Merrill Lynch, Pierce, Fenner & Beane,* 85 F. Supp. 104 (W.D. Ark. 1949), . . . recognized a private right of action under Section 17(a) and Rule 17a-5" (SIPC Br. 23). Actually, *Hawkins* did not discuss the question of implied rights of action with respect to Section 17(a) in particular, and did not hold that there was an implied right of action for violation of Section 17(a). *Hawkins* did assume that any provision of the 1934 Act would give rise to an implied remedy, but appears to have reached that conclusion because "the defendants . . . do not contend to the contrary". *Id.* at 121. One of several violations (including violations of Section 10(b) and Rule 10b-5) for which defendant was held liable as a "controlling person", however, was its correspondent's failure to file any Rule 17a-5 report. *Id.* at 124. Even assuming the doubtful proposition that *Hawkins* is correct, it is distinguishable. In

principles of statutory construction emphasized in *Amtrak* and *Barbour* (*see* pp. 9-15, *supra*), and recognized in *Cort* v. *Ash, supra,* 422 U.S. at 78. *See Ash* v. *Cort,* 496 F.2d 416, 426-429 (3d Cir. 1974) (Aldisert, J., dissenting), *rev'd,* 422 U.S. 66 (1975). *See also* Comment, *Private Rights of Action Under Amtrak and Ash: Some Implications for Implication,* 123 U. PA. L. REV. 1392, 1394 (1975) ("[T]his early test, if literally applied, would support implication in almost every federal statute . . . . Such a test does not consider whether an implied action would disparage potentially conflicting goals, nor does it require a court to examine the effectiveness of the existing enforcement scheme and, therefore, the need for private actions").

Even aside from the limitations emphasized in *Amtrak* and *Barbour* (which in any event control here), it is doubtful that brokerage firm customers ever can satisfy what the Trustee and SIPC concede is "the principal element of the classic statutory tort doctrine" (SIPC Br. 27), *viz.,* the requirement that they be members of "the class for whose especial benefit the statute was enacted" (a requirement which is also the first *Cort* v. *Ash* factor).

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the first place, *Hawkins,* which was an action against a brokerage firm rather than accountants, involved plaintiffs whose securities were converted and who satisfied the purchaser-seller requirement. Second, a brokerage firm's failure to file a report is a different violation from filing a misleading report, and is a violation for which there is no express remedy (since Section 18(a) applies only to misstatements in reports actually filed). Thus, while Section 18(a) would preclude any implied remedy for misstatements, it conceivably might not preclude an implied remedy for the failure to file any report at all. *See Kerber* v. *Kakos,* 383 F.Supp. 625 (N.D. Ill. 1974) (purchaser had implied right of action for issuer's failure to file Section 12(g) registration statement); *Myers* v. *American Leisure Time Enterprises, Inc.,* 402 F.Supp. 213, 215 (S.D.N.Y. 1975) (Section 18(a) remedy precluded any implied remedy for non-purchaser-seller "where the alleged violation of section 13(d) concerns not the failure to file the required reports but rather the filing of reports containing false or misleading statements or omissions"), *aff'd by oral opinion,* 538 F.2d 312 (2d Cir. 1976).

As already shown (pp. 7-8, *supra*), the language of Section 17(a) and the legislative history of the 1934 Act provide no support for the argument that Section 17(a) was enacted for the "especial benefit" of customers.

In *Cort* v. *Ash, supra,* the Court explained the "especial benefit" requirement in terms of whether there is "a clearly articulated federal right in the plaintiff . . . or a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard". 422 U.S. at 82. *See also J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433, *quoting Bell* v. *Hood, supra,* 327 U.S. at 684 (recognizing propriety of implication of right of action "where legal rights have been invaded") (quoted at Tr. Br. 26; SIPC Br. 51, 53). Unlike the proxy requirements involved in *Borak* (which, as shown by explicit legislative history, "stemmed from the congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange' "—377 U.S. at 431), and the requirements of the Fourth Amendment involved in *Bell* v. *Hood* and *Bivens* v. *Six Unknown Named Agents,* 403 U.S. 388 (1971), the reporting requirements of Section 17(a) have as their basic purpose the providing of information to the SEC and other regulatory agencies rather than to customers (*see* T. R. Br. 21-23, 63-64; pp. 6-8 and n.4, *supra*) and thus cannot be said to confer any legal rights upon the customers. As stated by the District Court, Section 17(a) was "not [designed] to create any rights in anybody" and "[t]here is no such 'pervasive legislative scheme' [as there was between the plaintiff class and the defendant class in *Borak*] in the case at bar" (A. 177, A. 182).

C. The Trustee And SIPC Err In Contending That An Implied Private Right Of Action Under Section 17(a) Is "Necessary".

In arguing that an implied private right of action under Section 17(a) is "necessary" (SIPC Br. 8-16, 42-50), the Trustee and SIPC not only improperly fail to acknowledge the overall scheme of "protections" for brokerage firm customers actually established by Congress (*see* pp. 10-12, *supra*), but also make two other basic errors: (i) they overstate the importance of the once-a-year audits of Section 17(a) reports performed by independent accountants, and (ii) they misstate the position of Touche Ross as to the scope of the appropriate state law remedies available to brokerage firm customers for accountants' malpractice.[10]

[10] SIPC attempts to dilute into meaninglessness the "necessity" requirement by arguing that an implied remedy need not be indispensable, but need only "aid" or "supplement" the Congressional goals (SIPC Br. 46-47). As pointed out by Touche Ross (T. R. Br. 59-60), SIPC's interpretation of "necessity" is incorrect and would license unbridled judicial legislation. *See* Comment, *Implying Private Causes of Action From Federal Statutes: Amtrak and Cort Apply the Brakes,* 17 B.C. INDUST. & COM. L. REV. 53, 58 (1975) (noting that "implying remedies where necessary to *effectuate* the congressional purpose is distinctly different from implying remedies where they might *enhance* the congressional purpose" and that "it is this [latter] type of free-wheeling approach to implied remedies which *Amtrak* was intended to preclude"); Comment, *Private Rights of Action Under Amtrak and Ash: Some Implications for Implication,* 123 U. PA. L. REV. 1392, 1427 ("The implication of *any* consistent remedy, however, renders useless the criterion that there be a need for such a remedy to accomplish the act's goals adequately. If Congress designs an enforcement scheme that proves effective in accomplishing the statutory goals, there is no reason to supplement that system simply because the supplemental remedy is consistent with the statute"); Climan, *Civil Liability Under the Credit-Regulation Provisions of the Securities Exchange Act of 1934,* 63 CORNELL L. REV. 206, 267 (1978) ("the Court's language [in *Piper*] represents a radical departure from *Borak*'s view of the courts as roving enforcers").

1. THE TRUSTEE AND SIPC OVERSTATE THE IMPORTANCE OF THE SECTION 17(a) REPORTS INVOLVED HERE. —As already noted (pp. 12-15, *supra*), acceptance of the basic premise of the Trustee and SIPC that accountants' "certifications of Section 17(a) reports are the *only* means through which the SEC and the self-regulatory organizations are assured that broker-dealers are not in violation of the net capital rule" (SIPC Br. 16) would undermine the statutory goal of requiring continuing inspections and monitoring by SIPC, the SEC and the self-regulatory organizations. That premise also is erroneous for the more basic reason that it overstates the importance of the Section 17(a) reports involved here. The Trustee and SIPC mislead in stating that "Congress considered, but ultimately rejected, requiring the government itself to audit SEC filings" and "[i]nstead, . . . chose to have such filings audited by independent public accountants", *citing* SEC Accounting Series Release No. 81 (Dec. 11, 1958), *reprinted in* 5 FED. SEC. L. REP. (CCH) ¶72,103 (SIPC Br. 14). The cited release discusses the fact that Congress chose not to have *registration statements filed pursuant to the 1933 Act* audited by government accountants, because "it was deemed essential to refrain from placing upon any Federal agency the duty of passing judgment upon the soundness of any security". *Id.* at 62,230. That consideration has nothing whatever to do with Section 17(a) of the 1934 Act, which expressly authorizes examinations by the SEC, and it is erroneous for the Trustee and SIPC to suggest that in 1934 Congress in any way recognized a need for Section 17(a) reports audited by a broker's independent accountants. The legislative history of Section 17(a) (which is referred to at T. R. Br. 46-47, and at pp. 7-8, *supra*) focused almost exclusively on examinations to be performed by the SEC pursuant thereto and upon the cost of such examinations.

Moreover, Congress knew in 1934 that the SEC's burden in examining brokerage firms for compliance with financial responsibility rules and bookkeeping requirements would be lightened by examinations conducted by the Exchange of its members' financial questionnaires (*see* T. R. Br. 65 n.40). *See Hearings on H. R. 7852 and H. R. 8720 Before the House Comm. on Interstate and Foreign Commerce,* 73d Cong., 2d Sess. 164-172, 189-190 (1934) (testimony regarding financial questionnaire requirement adopted by the Exchange in 1922 and separate independent audits conducted by the Exchange's accountants).

The Trustee and SIPC also seek to bolster the erroneous premise that the once-a-year audits of Section 17(a) reports are the SEC's exclusive means, as opposed to being merely just one aspect of the SEC's program, to enforce financial responsibility and other rules, by the misleading statement that "[p]rior to the adoption of the rule, the SEC noted that customer protection against the risk involved in leaving securities with broker-dealers would be increased by Rule 17a-5", *citing National Ass'n of Securities Dealers,* 12 S.E.C. 322, 329 n.9 (1942) (SIPC Br. 9, *see also* 28-29). In fact, what the SEC there stated was that protection of certain customers "will be increased by the requirements of our proposed Rule X-17A-5 *plus an exercise of the visitorial powers of the S.E.C., the NASD and others possessing similar powers*" (emphasis added). *Id.*

It also is misleading for the Trustee and SIPC to suggest that the Section 17(a) reports involved here "constitute an 'early warning system' which is designed to detect the financial unsoundness of broker-dealers at the earliest possible moment" (SIPC Br. 16). In fact, the phrase "early warning system" refers to other rules and procedures that were adopted after it had become apparent that the once-a-year audits did not provide information on a sufficiently timely and continuous basis and that there was a need for more close and continuing supervision by the SEC and other regulatory authorities. As the SEC itself explained,

> "Those techniques which had functioned well for regulatory purposes faltered heavily in the 1969-70 climate and the need for an early warning system became apparent. This may be explained as follows. First, the relatively leisurely pace of the annual reporting requirements and the consequent follow up of regulatory activity could not meet the needs of the kinetics which prevailed in the industry beginning in 1967. With the books and records of some brokers and dealers in the poor condition they were at the time, the problem for the auditors became a highly complex and laborious one." STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. NO. 91-231, 92d Cong., 1st Sess. 25, *see also* 26, 31, 39-41 (1971).

Thus, the Section 17(a) reports, though important, are simply one of the numerous means by which the SEC and other regulatory authorities attempt to obtain information for use in performing their regulatory tasks.

2. THE TRUSTEE AND SIPC MISSTATE TOUCHE ROSS' POSITION AS TO THE SCOPE OF THE APPROPRIATE STATE LAW REMEDIES.—Touche Ross has not argued, as the Trustee and SIPC erroneously state, "that state law remedies are appropriate . . . because they afford virtually complete immunity to accountants against customers' claims" (Tr. Br. 15, *see also* 32). In fact, Touche Ross has recognized that under New York law customers may recover for fraud on the part of accountants. *See Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 191, 174 N.E. 441,

449 (1931); *State Street Trust Co.* v. *Ernst,* 278 N.Y. 104, 112, 15 N.E.2d 416, 419 (1938); *cf. William Iselin & Co., Inc. v. Muhlstock, Elowitz & Co.,* 52 A.D.2d 540, 382 N.Y.S.2d 83 (1st Dep't 1976). Moreover, there are no significant variations among the laws of the various States in this regard; as Judge Mulligan stated, "should the actionable elements of fraud be provable, the States have universally permitted recovery to third parties who relied on the misrepresentations" (A. 220). Thus, unlike the proxy rules involved in *Borak,* which imposed requirements unknown to State common law, accountants' fraud and malpractice long have been a concern of State law, which supplies appropriate remedies therefor.

D. The Trustee And SIPC Err In Their Purported *Cort* v. *Ash* Analysis.

Even if *Cort* v. *Ash* were assumed to provide the appropriate analysis here (*but see* T. R. Br. 39-40, 54-55, 66-67), the purported analysis set forth by the Trustee and SIPC (SIPC Br. 26-52) is erroneous.

1. As already shown, the language and legislative history of Section 17(a) do not support the contention of the Trustee and SIPC that Section 17(a) was enacted for the "especial benefit" of brokerage firm customers, and the reporting requirements of Section 17(a) do not "create a federal right in favor of the plaintiff[s]" here (*see* pp. 6-8, 22-23, *supra*). Moreover, the carefully limited express remedy in Section 18(a) for misstatements in required reports, which is applicable to Section 17(a), reflects a Congressional intent that brokerage firm customers are not to derive any substantive legal rights or remedies from the reporting requirements of Section 17(a) (*see* pp. 6, 9, *supra*).

2. The express remedy of Section 18(a), together with the absence of any clear contrary evidence of legislative intent to permit a broader, additional implied remedy, reflects a legislative intent to deny such an implied remedy (*see* pp. 9-10, *supra*). The non-existence of any damage remedy for brokerage firm customers under the 1934 Act was *explicitly* recognized by Congress in enacting SIPA in 1970, and Congress clearly intended to fill that void not by providing such a damage remedy, but instead by enacting SIPA and creating SIPC to provide to such customers the additional financial protection that it thought appropriate (*see* pp. 11-12, *supra*).

3. It would not be "consistent with the underlying purposes of the legislative scheme" to accept the argument of the Trustee and SIPC that the regulatory authorities (upon which the 1934 Act and SIPA expressly place the pertinent inspection and monitoring duties) are not themselves to perform virtually all of those duties, and to hold accountants liable for their failure to detect such problems on the theory that Section 17(a) implicitly imposes those duties on them (*see* pp. 12-15, *supra*). The argument of the Trustee and SIPC to the contrary magnifies out of all proportion the responsibilities of the accountants and the importance of the Section 17(a) reports involved here (*see* pp. 25-27, *supra*). Moreover, it would frustrate the salutary purposes of the purchaser-seller limitation on express damage remedies embodied in the legislative scheme to permit the type of speculative claim asserted here (*see* pp. 16-17, *supra*).

4. Accountants' malpractice traditionally has been a concern of State law, which affords appropriate remedies, "so that it would be inappropriate to infer a cause of action based solely on federal law". The argument of the Trustee and SIPC to the contrary misstates the scope of the appropriate State law remedies and Touche Ross' position with respect thereto (*see* pp. 27-28, *supra*).

II

The Trustee And SIPC Err In Arguing That Section 17(a) Imposes Duties Upon Accountants, And That A Private Right Of Action May Be Implied In The Absence Of *Scienter*

A. The Trustee And SIPC Err In Contending That Section 17(a) Imposes Duties On Accountants Such As Touche Ross.

The Trustee and SIPC argue that Section 17(a) and Rule 17a-5 impose duties upon accountants, and that an implied private right of action under Section 17(a) should exist not only against the broker-dealers subject thereto, but also against accountants such as Touche Ross (*see* Tr. Br. 6-8, 27; SIPC Br. 11-16, 30-31). The Trustee and SIPC do not dispute that the language of Section 17(a) does not refer to, and does not expressly purport to impose any duty upon, accountants who have audited and expressed an opinion concerning financial reports filed pursuant thereto. Nor do they cite any concurrent legislative history which supports their contention that Section 17(a) was directed at accountants. They rely solely on Rule 17a-5, contending that it gives rise to duties manifestly not inherent in the words of Section 17(a) itself.[11]

[11] SIPC also purports to find recognition of a "duty" placed on accountants by distorting an article by Mr. Weinstein, who is a partner in Touche Ross (*see* SIPC Br. 15-16). Mr. Weinstein's article in fact emphasized (in passages that SIPC conveniently fails to quote) that "every instance of management fraud cannot be detected", that accountants "cannot be scapegoats", that the "public must mature and temper its expectations" as to what can be expected from accountants, and that "[t]he public is not served by having [the accounting] profession exposed to unlimited and unbearable liability". Weinstein, *A Time of Travail and Challenge,* 44 CPA J. 29, 30 (Dec. 1974). SIPC similarly distorts and takes out of context a prefatory statement in an AICPA publication, AUDIT OF BROKERS AND DEALERS IN SECURITIES (1977), to suggest that the AICPA has "recognized" accountants' alleged duty under Rule 17a-5 (SIPC Br. 15). The actual position of the AICPA is set forth in its *amicus curiae* brief in this case.

However, Rule 17a-5 does not give rise to any such duties. By its own terms, it is expressly limited to broker-dealers and imposes upon them alone the duty of filing reports (together with any concomitant duty to prepare them accurately). *See* Rule 17a-5(a), 17 C.F.R. §240.17a-5(a)(1972). Subdivisions (g), (h) and (i) of Rule 17a-5 (*cited at* Tr. Br. 6-8, 27; SIPC Br. 12-13), relate to the accountant's "certificate" which must be obtained by a broker-dealer and filed with its Section 17(a) reports. Those subdivisions do not purport to impose duties upon an accountant. They direct the broker-dealer to obtain a certificate stating the scope of the audit conducted, "whether" it was made in accordance with generally accepted auditing standards, "whether" it omitted any necessary procedure, what opinion the accountant reached about the financial report of the broker-dealer and what exceptions, if any, the accountant took to it. The requirements of subdivisions (g), (h) and (i) are, like the whole of Rule 17a-5, expressly addressed to the broker-dealer filing the report, and they enunciate the broker-dealer's duty to obtain an appropriate certificate, not any duty of the accountant.

Just as Rule 10b-5 must be construed in a manner consistent with Section 10(b) of the 1934 Act, *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 212-214 (1976); *Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 472, Rule 17a-5 must be construed in a manner consistent with Section 17(a), which only authorizes the SEC to impose its record-keeping and reporting requirements on certain persons, including broker-dealers, but not on accountants. As *Hochfelder* states,

> "*The rulemaking power* granted to an administrative agency charged with the administration of a federal statute *is not the power to make law.* Rather, it is "'the

> power to adopt regulations to carry into effect the will of Congress as expressed by the statute.'" . . . Thus, despite the broad view of the Rule advanced by the Commission in this case, *its scope cannot exceed the power granted the Commission by Congress"* (emphasis added). 425 U.S. at 213-214.

A similar understanding is reflected in the Senate report on the 1934 Act, which observes that while "considerable latitude is allowed for the exercise of administrative discretion", nevertheless *"well defined limits* must be indicated within which the authority of such administrative authority may be exercised" (emphasis added). S. REP. No. 792, 73d Cong., 2d Sess. 5 (1934).[12]

The proposition asserted by the Trustee and SIPC "that rules *properly* promulgated by a government agency pursuant to a congressional enabling mandate 'have the force of law' ", and that such rules " 'supplement the statute' under which they were promulgated" and "may provide 'the basis for imposition of liability'" (emphasis added) (SIPC Br. at 31), and the cases they cite for that proposition, are not relevant. Neither that proposition nor any of those cases purports to authorize an administrative agency to impose by rule liabilities and duties upon a class of persons not contemplated by the enabling statute.[13]

[12] It is to be noted that whatever rule-making power may be conferred by present Section 17(e) of the 1934 Act, 15 U.S.C. §78q(e), which expressly empowers the SEC to "prescribe the form and content of financial statements filed pursuant to this title and the accounting principles and accounting standards used in their preparation", and which was enacted as part of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, §14, 89 Stat. 137 (1975), was not available in 1972. *Cf. Rothstein* v. *Seidman & Seidman,* 410 F.Supp. 244, 249 (S.D.N.Y. 1976).

[13] SIPC's contention that "not even Touche Ross argues that, in promulgating the rule, the SEC exceeded the power congressionally delegated to it by the section" (SIPC Br. 31 n.30) misses the point. While the SEC has properly required broker-dealers to file reports certified by independent accountants, it cannot properly thereby attempt to impose any liabilities and duties upon the accountants who are retained by the broker-dealers.

B. The Trustee And SIPC Err In Contending That Section 17(a) Creates An Implied Private Right Of Action In The Absence Of *Scienter.*

The Trustee and SIPC offer no reasoning beyond their own bald conclusion for creating an implied private right of action under Section 17(a) for accountants' *negligence* (*see* Tr. Br. 51-52). They overlook this Court's reasoning in *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 210, that it would "nullify the effectiveness of the carefully drawn procedural restrictions" on the express civil remedies for negligent conduct in the securities laws to permit implied actions in the absence of *scienter* (*see* T. R. Br. 80-81). They also overlook *Hochfelder's* explicit recognition of the significance of the fact that the original proposed version of Section 18(a) would have imposed liability for negligence, and that Section 18(a) was thereafter intentionally changed in subsequent bill drafts so as to eliminate liability for negligence (*see* T. R. Br. 81-82).

The procedural argument of the Trustee and SIPC for avoiding the *scienter* issue has no merit. The issue was briefed and argued in both the District Court and the Court of Appeals. Moreover, the issue properly was raised in Touche Ross' Petition for a Writ of Certiorari. Since liability may not be imposed for negligence under Section 18(a), creation of an implied right of action for negligence under Section 17(a) would mean that "the implied remedy under Section 17(a) would be broader than the limited express remedy of Section 18(a)" (*see* the first question presented in Touche Ross' Petition for a Writ of Certiorari). The *scienter* issue therefore is one of the subsidiary questions "fairly comprised" within the Petition. *See* Rev.R.Sup.Ct. 40(d)(1)("The statement of a question presented will be deemed to include every subsidiary question fairly comprised therein"); *Procunier* v. *Navarette,* 434 U.S. 555, 559-560 n.6 (1978).

III

The Trustee Errs In Arguing That He May Assert Implied Section 17(a) Rights Of Action Of Weis Customers Whose Property He Has Been Unable To Return

The Trustee asserts that the "key" to understanding his purported right to assert implied Section 17(a) rights of certain Weis customers is his contention "that the Trustee's Section 17 claims are for damages to a specific and separate fund of customer property, not for damages . . . to any property deemed part of Weis' assets" (Tr. Br. 52). In other words, argues the Trustee, he may assert those rights because he seeks damages not with respect to interests of the *bailee* Weis, but instead with respect to interests and on behalf of the *bailor* customers. However, the Trustee's distinction is completely inconsistent with the underlying rationale of the theory upon which he premises his purported right to recover (*viz.*, the theory that the Trustee, as Weis' successor, is a bailee of customer property), and only demonstrates that the Trustee's reliance on a bailment theory is misplaced.

The Trustee has the law of bailment backwards. Thus, his basic error is his failure to acknowledge that the common law of bailment upon which he relies (but which in any event is not applicable here for the reasons set forth at T. R. Br. 91-94) permits a bailee to recover precisely because it does "deem" the bailed property to be part of the *bailee's* assets (*see* T. R. Br. 86-91). The Trustee thus completely ignores, and does not even attempt to (because he cannot) refute, Touche Ross' demonstration that the basis of the bailee's right to recover is *his own* possessory interest, that his recovery is permitted solely on the theory that "the wrongdoer . . . must treat the possessor as the owner of the goods *for all purposes*", and

that "[t]he chattel that has been converted or damaged is *deemed to be the chattel of the possessor and of no other*" (emphasis added). *The Winkfield,* [1902] P. 42, 54-55, 60 (C.A.).

The right of a bailee to sue is not derived, either logically or historically, from any theory that the bailee asserts the personal rights of the bailor as the bailor's legal representative. The Trustee's contrary assertion, which is based on misinterpretation of ambiguous *dicta* taken out of context, is clearly erroneous.[14] Moreover, the Trustee confuses the *measure* of a bailee's permissible recovery (which is the full value of the property rather than the pecuniary loss actually suffered by the bailee) with the *basis* for permitting the recovery (which is that the property is treated as if it were the bailee's own property, and not that the bailee is allowed to assert the personal rights of the true owner) (*see* Tr. Br. 56).

Touche Ross' argument is not in any way "contradicted" by—but instead is entirely consistent with and required by the logic of—the "three elementary principles of bailment law" cited by the Trustee.[15] *First,* the principle that a recovery by the bailee is a bar to a subsequent recovery by the bailor for the same injury to the bailed

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[14] The unreliable nature of the Trustee's authorities is exemplified by his citation of, and extensive quotation from, *Baldwin* v. *Hill,* 315 F.2d 738, 742 (6th Cir. 1963) (Tr. Br. 57). What the Trustee fails to reveal is that *Baldwin* v. *Hill* does not hold that a bailee may sue third parties on claims belonging to the owner and as the owner's legal representative, but rather that under the Michigan automobile "guest passenger statute" a bailee-passenger is to be considered as the "host" (that is, the "owner") rather than as a "guest".

[15] The Trustee states his "three elementary principles" as follows: "(1) either the bailor or bailee can bring an action for the same injury to the bailed property, and a recovery by one is a bar to a subsequent recovery by the other; (2) a bailee can sue for a full recovery beyond the extent of its own direct harm and regardless of any pre-existing liability it might have to the bailor; and (3) the bailee holds such recovery in trust for the bailor" (Tr. Br. 58).

property is entirely consistent with the underlying theory that the property is treated as if it were the bailee's own property, and does not require any conclusion that the bailee may assert the personal rights of the bailor. It is neither a premise nor a corollary of that principle that the personal rights of the bailee and the bailor must be equated. As shown by Touche Ross (T. R. Br. 90), there are other well-recognized situations in which the bailor may be able to recover even though the bailee cannot. *Second,* the principle that a bailee can sue for a full recovery beyond the extent of his own direct harm and regardless of whether he has any liability to the bailor also is based on the theory that the property is treated as though it belonged to the bailee alone—as was squarely held in the seminal case, *The Winkfield, supra.* That principle is in no way based upon any theory, and does not require any inference, that the bailee is asserting the bailor's personal rights. The bailee's freedom from liability to the bailor does not limit his right to recover precisely because the law is unconcerned, insofar as the wrongdoer is implicated, with who the true owner really is and what his personal rights are (*see* T. R. Br. 90-91). Indeed, as Touche Ross has noted (T. R. Br. 94 n.52), the traditional doctrine has been criticized for permitting the bailee to recover without the consent of the true owner for the very reason that, in steadfastly pursuing its fiction that the bailee is to be treated as though he actually owned the property in order to provide him a basis to assert possessory remedies, it may be unduly callous towards the interests of the true owner. *Third,* the principle that a bailee holds any recovery in excess of his own damages in trust for the bailor is not based upon and provides no basis for the Trustee's argument that the bailee may sue as the bailor's legal representative (*see* T. R. Br. 88-89 n.50 and authorities there cited). The bailee's duty to account

arises only *as a consequence* of his recovery in his own right, *and only if there is such a recovery.* The basis of the duty is the theory that the recovery takes the place of the property and that it would unjustly enrich the bailee to permit him to retain the proceeds of the property even though he otherwise might have no liability to the bailor for the loss thereof. But the duty to account for any recovery does not create or enhance the bailee's right to recover. Neither logic nor any valid policy permits the bailee to infer from the consequential duty to account to the bailor (the only predicate for which is the fact of recovery) any right to assert as against the wrongdoer any of the bailor's personal rights simply in order to create a recovery (*res*) as to which such a duty to account could attach. Simply put, the bailee's duty to account to the bailor, and the fact that the bailor might thereby obtain the proceeds of any recovery by the bailee, are "immaterial" to the question of whether the bailee has any right of action against the wrongdoer. *Berger* v. *34th St. Garage, Inc.,* 274 App.Div. 414, 420, 84 N.Y.S.2d 348, 353 (1st Dep't 1948), *mot. for leave to app. denied,* 275 App.Div. 660, 86 N.Y.S.2d 667 (1st Dep't 1949); *The Winkfield, supra,* [1902] P. at 60.

The Trustee's reliance on Rule 17(a), F.R.Civ.P., also is misplaced (Tr. Br. 57-58). Rule 17(a) has no effect on substantive rights and does not "recognize" any substantive right of a bailee to assert the personal rights of the bailor as his legal representative in contexts where substantive legal principles do not create any right of recovery in the bailee himself (*see* T. R. Br. 94-95). All that Rule 17(a) recognizes is the fact that there is no procedural obstacle to a suit by a bailee in his own name where substantive legal principles make him—and not just the bailor—"a real party in interest", *i.e.,* "[*a*] *party who, by the substantive law, has the right sought to be enforced*".

3A MOORE'S FEDERAL PRACTICE ¶17.02 at 17-13, ¶ 17.07 at 17-65 (2d ed. 1978).

Caplin v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), which holds that a trustee having powers that are in all pertinent respects the same as those of the Trustee here has no right to assert rights of action belonging to third parties (*see* T. R. Br. 96-98), is asserted by the Trustee to be distinguishable only because of the rights that he purports to have under his "bailee" theory (Tr. Br. 59). Since the "bailee" theory gives the Trustee none of those rights, *Caplin* applies here and precludes the Trustee from asserting any customer rights of action.

The Trustee errs not only in his effort to uphold the judgment of the Court of Appeals in his favor on the "bailee" question, but also in his improper attempt to overturn and modify that judgment so that he may seek a much larger recovery than the judgment provides. The Court of Appeals held that the Trustee has a claim for relief "on behalf of such customers as have not been fully reimbursed by SIPC", to "the extent that [those] customers have claims that have not been satisfied by Weis in liquidation . . . or by SIPC" (A. 202, A. 204). But the Trustee argues that if SIPC's claims as "subrogee" of customers are held to be without merit (as they should be), the Trustee also should be permitted "to sue for the damages claimed by SIPC" (*i.e.*, for an additional $14,000,000), because "[a]s between the Trustee and SIPC, it is of no importance which entity recovers this amount" (presumably because in that event the Weis estate would merely be a conduit to funnel the funds to SIPC, which is a subrogee of customer claims against the estate and particularly the single and separate fund, to the extent of its advances) (Tr. Br. 12, 52 n.17). However, the Trustee has not filed any cross-petition for certiorari

seeking that result, which would very substantially enlarge his rights under the judgment below. To permit the Trustee to seek such relief at this late juncture would violate the well-established rule, which often has been repeated by this Court, that a respondent such as the Trustee cannot seek by way of argument to overturn or modify any portion of a judgment below without filing a cross-petition for certiorari.[16] However, even if the Court were to reach the merits of the Trustee's newly-interposed claim for additional relief, such relief should be denied because no Section 17(a) right of action should be implied on behalf of customers to recover losses for which they have been compensated by SIPC (*see* T. R. Br. 77 n.45, 103-104), even if it be assumed that the Trustee may recover customers' uncompensated losses in accordance with the holding of the Court of Appeals.

IV

SIPC Errs In Arguing That It May Assert Implied Rights Of Action As Subrogee Of Weis Customers For The Payment Of Whose Claims It Has Advanced Funds To The Trustee

SIPC does not dispute that the statutory subrogation rights provided to it by Section 6(f)(1) of SIPA, 15 U.S.C. §78fff(f)(1) (1970), are limited to the "claims" of customers (for the payment of whose "claims" SIPC has advanced funds to the Trustee) *against the estate of the brokerage firm* (*i.e., the Weis estate*) (*see* T. R. Br.

[16] *See, e.g., United States* v. *Reliable Transfer Co., Inc.*, 421 U.S. 397, 401 n.2 (1975); *United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 226-227 n.2 (1975); *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 61-62 n.11 (1975); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 381 n.4 (1970); *LeTulle* v. *Scofield*, 308 U.S. 415, 421-422 (1940); *Alexander* v. *Cosden Pipe Line Co.*, 290 U.S. 484, 487 (1934); *cf. Langnes* v. *Green*, 282 U.S. 531, 535-539 (1931); *Morley Construction Co.* v. *Maryland Cas. Co.*, 300 U.S. 185, 190-193 (1937).

100; SIPC Br. 57 and n.52). SIPC's arguments, by which it seeks to slip away from the unavoidable conclusion that the express subrogation provision of Section 6(f)(1) was intended by Congress to provide SIPC's exclusive subrogation rights, are without merit.

SIPC argues that Section 2 of SIPA, 15 U.S.C. § 78bbb (1970), makes SIPA an amendment to the 1934 Act, and that SIPC thereby obtains some benefit from Section 28(a) of the 1934 Act, 15 U.S.C. §78bb(a), which is intended to preserve pre-existing common law rights of investors that would exist in the absence of the 1934 Act. SIPC has no such rights, however, because it is solely a statutory creature which owes its very existence to SIPA, and because the rights that it seeks to assert here arise from and are premised upon its statutory duty to advance funds (a duty which SIPA creates and which would not even exist in the absence of SIPA). Moreover, the incorporation of SIPA into the 1934 Act was intended only for the purpose of making it clear that the rights conferred on investors by SIPA are in addition to whatever pre-existing rights the investors had under the 1934 Act, and was not intended to confer any rights on, or supplement the rights of, SIPC—as even the Court of Appeals majority recognized (A. 201 n.13).[17]

SIPC also erroneously argues that the inference that the express statutory subrogation provision is exclusive must yield to a purported "generally expressed legislative

[17] *Federal Marine Terminals, Inc.* v. *Burnside Shipping Co.*, 394 U.S. 404 (1969), which SIPC cites (SIPC Br. 59), held only that a stevedoring contractor's statutory subrogation to its deceased employee's representative's rights against third persons did not abrogate its own, pre-existing, direct common law right of action. It did not involve judicial creation of a new implied federal right of action, nor an entity such as SIPC which is a creature of the statute which creates it, nor the issue whether such an entity has subrogation rights in excess of those enumerated in the statute's express subrogation provision.

policy" to "maximize SIPC's recovery of the funds it expends" (SIPC Br. 59-61). However, the provisions of SIPA to which SIPC refers as purportedly providing implicit evidence of "legislative policy" refer only to SIPC's right to receive payments from the single and separate fund or the general estate of the debtor, and not from third parties; and SIPC overlooks the explicit legislative history which sets forth the actual Congressional intention that any recoupment by SIPC would be from the debtor's estate and not from third parties such as Touche Ross (*see* T. R. Br. 107-108).

Nor must SIPC be permitted to recoup its losses to keep Touche Ross from escaping "the legal effect of the breach of [its] pre-existing duty", as SIPC argues (SIPC Br. 60). The "duty" which SIPC seeks to impose here upon Touche Ross is a new duty, namely responsibility for the "efficacy of the 'early warning system'" and "the burden of providing customer protection" (*id.*). That duty is one which arises from SIPA and which SIPA squarely places upon SIPC (exclusively insofar as monetary liability is concerned) and the other regulatory authorities, and not upon accountants such as Touche Ross (*see* pp. 12-15, *supra*). SIPC seeks simply to shift that duty to Touche Ross. Insofar as Touche Ross' actual pre-existing duties are concerned, it remains liable in common law actions for accountants' malpractice for any breach thereof, and therefore does not receive any "windfall benefit" (*see* T. R. Br. 107).

SIPC unpersuasively responds to Touche Ross' showing (*see* T. R. Br. 102-106) that, in order to protect customers, it is unnecessary to imply a right of action under Section 17(a) on their behalf for losses for which SIPC has compensated them[18] and to grant subrogation

[18] It also is unnecessary, in order to effectuate Congress' goals, to imply a right of action on behalf of customers for losses that are not covered by SIPA protection. The SIPA limits reflect a Congressional concern to protect primarily the average investor, and a Congressional belief that large investors should be responsible personally for safeguarding their own interests. *See* 116 CONG. REC. 40872 (1970).

rights to SIPC in addition to those expressly specified in SIPA, because the only beneficiary thereof will be SIPC rather than the customers (and because the result otherwise would be inconsistent with the statutory purposes). SIPC's only response is its suggestion that if it is permitted to refill its coffers at Touche Ross' expense, it might enhance its ability to provide protection in the future to customers of other brokerage firms (SIPC Br. 60-61). That remote and speculative possibility provides no adequate basis for the judicial invention of rights that Congress did not create and liabilities that Congress did not impose. *Cf. Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.*, 417 U.S. 703, 715 (1974); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 254 (1951).

CONCLUSION

For the foregoing reasons, and the reasons set forth in Touche Ross' main brief, the judgment of the Court of Appeals should be reversed.

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IN THE

Supreme Court of the United States

October Term, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

v.

EDWARD S. REDINGTON, as Trustee for the Liquidation of the business of WEIS SECURITIES, INC., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE*

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE*

Preliminary Statement

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae* pursuant to Rule 42(2) of the Rules of this Court,[1] addressed to certain issues specified below, and urges this Court to reverse the Order of the United States Court of Appeals for the Second Circuit entered in these proceedings on April 21, 1978, which Order reversed the judgment entered by the District Court for the Southern District of New York dismissing the Complaint herein.

[1] Letters of the petitioner and respondents giving their consent to the filing of this brief have been filed with the Clerk of this Court.

Opinions Below

The opinion of the majority of the Court of Appeals (Lumbard and Timbers, C.J.J.) reversing the decisions of the District Court and remanding the case and the dissenting opinion (Mulligan, C.J.), [Current] CCH Fed. Sec. L. Rep. ¶ 96,404 (2d Cir. 1978), are not officially reported and are printed in the Appendix to the Petition for Certiorari. The Opinion of the District Court dismissing the complaint is reported at 428 F. Supp. 483 (S.D.N.Y. 1977).

Question Presented

The Institute as *amicus curiae* addresses solely the first question upon which this Court has granted certiorari. That issue may be restated as follows:

> Should a private right of action for damages be judicially implied under Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q (the "1934 Act") and Rules 17a-5 promulgated thereunder, 17 C.F.R. § 240.17a-5, in favor of brokerage house customers against accountants in connection with their opinion regarding allegedly false or misleading financial statements of the broker, absent any allegation that the customers purchased or sold securities in reliance on the allegedly erroneous statements?[2]

Interest of the Institute as *Amicus Curiae*

The Institute is the only national accounting association whose membership is limited to certified public accountants;

[2] The Institute has not formulated and does not express any position with respect to the other issues presented by petitioner.

it has approximately 130,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in the pursuit of that purpose, the Institute has come to be accepted as the authoritative source of standards and procedures in its field. Most particularly, the Institute develops the auditing standards which, after formal approval by vote of its members, are deemed "generally accepted" and which form the backdrop of this litigation.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed, under the rubric of Section 17(a), on auditors in connection with their performance of engagements governed by such generally accepted auditing standards. The Institute was invited to and did submit a position paper to the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act *(Hearings on S. Res. 84 (72 Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate,* 73d Cong., 1st Sess., pt. 15 at 7207-10 (1934) (hereinafter cited as *1934 Hearings*)) and was accorded permission by this Court to file a brief *amicus curiae* in support of the petition for a writ of certiorari in this case.

The holding below that customers who neither purchased nor sold securities in reliance on allegedly erroneous financial statements have standing to invoke a private cause of action under Section 17(a) and the unsatisfactory analysis upon which that holding was reached transcend the interests of the parties litigant and are of profoundly disturbing significance to the accounting profession as a whole.

The Institute here contends that the holding below frustrates congressional intent as derived from the statute

and legislative history, is unnecessary to achieve the purposes Congress sought to achieve in creating the reporting provisions, and creates, with respect to Section 17 and the other reporting provisions of the 1934 Act, an indeterminate liability to an undefined class without any Congressional definition of the contours of such liability.

Statement

Weis Securities, Inc. ("Weis"), a defunct brokerage firm, was liquidated in 1973 pursuant to the provisions of the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa *et. seq.* ("SIPA"). The Trustee of Weis and the Securities Investor Protection Corporation ("SIPC") commenced this action for damages in 1976 in their own rights and respectively as bailee of Weis customers' property and as subrogee of the rights of Weis customers whose claims were paid by SIPC. They alleged that Touche Ross & Co., the accounting firm which audited Weis' financial statements in the years prior to Weis' bankruptcy, rendered a false or misleading opinion regarding those statements in violation of Section 17(a) of the 1934 Act and SEC Rule 17a-5.

Neither of the plaintiffs, nor the customers whose claims they claim to represent, asserts injuries arising out of a purchase or sale of securities. Rather, each relies on the theory that Weis' false and misleading financial statements prevented SIPC from taking appropriate actions to ward off financial collapse.[3] The Trustee and SIPC commenced

[3] Immediately following the discovery of Weis' financial condition in 1973, the SEC brought an action against Weis and certain of its officers seeking injunctive relief alleging violations of the securities acts. Further, an indictment was filed against former Weis officers in *United States* v. *Arthur Levine, et al.* alleging violations of the securities acts and fraudulent concealment.

an identical action against Touche Ross & Co. in the New York State courts asserting common law claims of accountants' negligence and malpractice in July 1975, almost one year prior to the commencement of the federal action.[4]

The majority of the court below determined that a private right of action exists under Section 17(a) of the 1934 Act in favor of brokerage house customers against an accounting firm on the basis of the latter's opinion concerning the broker's allegedly false financial statements, notwithstanding the customers' failure to purchase or sell securities in reliance on those statements. To reach this conclusion the Court of Appeals necessarily and expressly rejected the District Court's holding that Section 18(a) of the same act, which provides explicit remedies for violations of the reporting provisions of the 1934 Act including Section 17(a),[5] is the exclusive source of private remedies for any such violation.

Judge Mulligan forcefully dissented on the grounds that the implication of a private cause of action under Section 17(a) in favor of plaintiffs who would have no standing under Section 18 of the 1934 Act violated this Court's teachings regarding statutory construction and was superfluous in view of state law remedies.

[4] In the state court action, the parties are continuing with discovery. (Appendix to Petition for Certiorari at 6a, n.7).

[5] Other reporting sections of the 1934 Act are Sections 12(b), 12(g), 13, 15(b)(1), 15(d), 15A(a), and 16(a). They have in common the underlying purpose that disclosure be afforded through required filings made with the SEC.

ARGUMENT

I.

Implication of a private right of action pursuant to Section 17 of the 1934 Act in favor of persons who neither purchased nor sold securities at a price affected by the allegedly false or misleading statements sharply conflicts with the text of the 1934 Act, the legislative history and other provisions of the securities laws.

The implication of a private right of action under Section 17(a) of the 1934 Act finds no warrant in either the language of that section individually or the provisions of the 1934 Act as a whole. Not a word indicates that any of the reporting sections was intended to afford the basis for civil liability in damages to anyone who could claim to be a beneficiary of those reports. The 1934 Act as a whole represents a deliberately drawn legislative balance apportioning enforcement among administrative regulation, self-enforcement and liability to third parties. An examination of the text of the 1934 Act and the legislative history persuasively shows that Congress, as part of that regulatory scheme, carefully circumscribed private rights of action in a fashion precluding the claims asserted here.

A. The Text of the Statute Limits Standing to Sue for Violation of Section 17(a) to those Who Purchased or Sold a Security at a Price Affected by the Misstatement.

This Court is now called upon to consider yet another attempt to assert privately a cause of action under the 1934 Act. Such an attempt brings to the fore an analytical process in which this Court has taken pains repeatedly to emphasize, particularly with respect to the securities laws, that "[t]he starting point in every case involving construction of a statute is the language itself." *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 472 (1977); *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 197 (1976) ("*Hochfelder*"), quoting *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 756 (1975) (Powell J. concurring) ("*Blue Chip*").[6]

The text of Section 17(a), unlike all other sections of the 1934 Act in which private remedies have been implied, does not proscribe as unlawful any conduct whatsoever; it simply sets forth certain bookkeeping and reporting requirements.[7]

And, in Section 18(a), Congress squarely limited standing to sue for damages attributable to a false or misleading statement filed with the SEC pursuant to the 1934 Act to those "who in reliance upon such statement, shall have purchased or sold a security at a price affected by such statement," 15 U.S.C. § 78r(a). This is the language which Congress employed. Nowhere in the 1934 Act did Congress indicate any intention to expand the contours of a private right of action for violation of Section 17(a) beyond that permitted in Section 18(a).

Yet the court below dismissed perfunctorily the limitations of Section 18(a). It ignored the reminders by this Court, in both *Blue Chip* and *Hochfelder,* that "the interdependence of the various sections of the securities

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[6] See also, *United States* v. *Bass,* 404 U.S. 336, 339 (1971); Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Colum. L. Rev. 527, 543 (1947).

[7] The Senate Report accompanying the 1975 Amendments (Pub. L. 94-29, 89 Stat. 137) affirms the reporting nature of that section:

> Section 13 of the bill would amend section 17 of the Exchange Act by deleting subsection (a) and inserting several new subsections concerning the authority of the Commission and the appropriate regulatory agencies to prescribe record-keeping, reporting and maintenance requirements and to conduct examinations of persons subject to their respective jurisdictions.

S. Rep. No. 94-75, 94th Cong., 1st Sess. 119 (1975).

laws is certainly a relevant factor in any interpretation of the language Congress has chosen . . . ." 425 U.S. at 206, quoting *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969).

In *Blue Chip*, this Court found it "anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action [with respect to Rule 10b-5] beyond the bounds it delineated for comparable express causes of action [in Section 18]."[8] The holding below is even more anomalous in that it implied a cause of action beyond the bounds within which Congress expressly chose to confine that very cause of action.

The court below was, in effect, forced to reason that Section 18(a) is not applicable because it recognized that its holding exceeded the specific terms of the statute sought to be interpreted and from which the right of action is said to be implied. In view of the clarity of the statutory language, however,

> . . . and mindful that the language of a statute controls when sufficiently clear in its context, *United States* v. *Oregon*, 366 U.S. 643, 648 (1961); *Packard Motor Car Co.* v. *NLRB*, 330 U.S. 485, 492 (1947), further inquiry may be unnecessary. We turn now, nevertheless, to the legislative history of the 1934 Act to ascertain whether there is support for the meaning attributed to [Section 17] by the [court below].

Hochfelder, supra at 201; *see United States* v. *Bass, supra; United States* v. *Campos-Serrano*, 404 U.S. 293, 297-98 (1971); *Toussie* v. *United States*, 397 U.S. 112, 120-22 (1970).

B. The Legislative History: Standing to Sue for Violation of Section 17(a) is Sharply Limited.

The legislative history overwhelmingly demonstrates that Congress meant what it said in Section 18(a) in limiting standing to sue to those who purchased or sold a security at a price affected by a misleading statement filed with the SEC.

Congress considered the wisdom of creating a private right of action for violation of the reporting sections only in connection with fashioning the terms of Section 18(a). Virtually every version of Section 18(a) that was presented to the House or Senate limited standing to sue in the same terms as Section 18(a) in its final form. This consistent uniformity does not reflect Congressional indifference to the limitation of the class of plaintiffs who could bring such actions; to the contrary, Congress consciously intended exactly that limitation. The limitation was insisted on, for example, by Speaker Rayburn in explaining the bill he himself sponsored:

> Mr. Hollister. The gentleman keeps referring to the issuer or the seller. This is a general clause and covers anybody making any kind of statement in any

[8] *Blue Chip, supra* at 736.

The determination below that Congress did not implicitly choose to deny a private right of action under Section 17(a) is based on the court's reasoning that Section 17(a) is distinguishable from the statutory schemes in cases denying a private remedy where a particular agency was vested with exclusive enforcement. In support, the court cited *Cort* v. *Ash*, 422 U.S. 66 (1975); *SIPC* v. *Barbour*, 421 U.S. 412 (1975); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) (*"Amtrak"*). *Cort, Barbour* and *Amtrak*, however, do not stand for the proposition, or even suggest, that an implicit Congressional intent to deny a private remedy can only be found where the statutory scheme endows an agency with exclusive enforcement authority. In each case denying such implicit intent this Court based its decision on a careful analysis of the language and structure of the 1934 Act and the legislative history. No such analysis was undertaken by the court below.

kind of document or in any kind of paper that is filed. It includes accountants, lawyers, or any other expert.

Mr. Rayburn. No.

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[A request of additional time was made]

Mr. Rayburn. I want to read this part of the section to the gentleman:

Who, in reliance upon the statement, shall have purchased or sold a security.

Mr. Hollister. Yes; that is the man who is going to sue. I am talking about the report that is made. This refers to any statement that is made in any report under this bill, if it contains a misleading statement.

Mr. Rayburn. If upon that report somebody bought or sold a security and lost money relying upon the statement that was false.

78 CONG. REC. 8040 (1934).

That intent could hardly be clearer. In the Senate, it was reenforced by Thomas Corcoran, the author with James Landis and Benjamin Cohen of the 1934 Act. After reading Section 18,[9] Corcoran noted "That is the provision of the Securities Act toned down a little," clearly referring to the same purchaser-seller limitation found in Sections 11 and 12 of the Securities Act of 1933, 15 U.S.C. §§ 77k and l. *1934 Hearings* at 6564.

Indeed, Congress expressed the concern that, even with the purchaser-seller limitation, the original drafts of Section 18 went too far. Concoran and others were disturbed by a long period of limitations giving rise to the possibility of "blackmail". *1934 Hearings* at 6565. The Institute expressed its concern over the amount of damages originally provided. *1934 Hearings* at 7207-10. These matters were addressed, and Section 18 was accordingly tightened.

[9] Section 17 of The Fletcher Act which later became Section 18.

The decision below, therefore, enjoys no support in the legislative history.[10] The limitation discarded below was consciously required in 1934 and not even in 1975, when Congress rewrote Section 17, was that limitation modified.

The 1975 Amendments were in large part adopted in response to the financial collapse of many brokerage firms and the consequent damage resulting to customers from such failures. Congress authorized the SEC to prepare a Study of Unsafe and Unsound Practices of Brokers and Dealers pursuant to Section 11(h) of the Securities Investor Protection Act of 1970, 15 U.S.C. § 78kkk(h), and that report and the *Securities Industry Study Report of the Senate Subcommittee on Securities* (S. Doc. No. 93-13, 93d Cong., 1st Sess. 1973) were the sources of the amendments. Yet neither Congress nor the SEC ever suggested that

[10] In its scanty treatment of the legislative history, the court below cited Exchange Act releases pertaining to Rule 15c3-1 as support for its conclusion that a private remedy is necessary to accomplish the purposes of Section 17. Beyond the doubtful relevance of the releases to the issue at hand, one of the releases, No. 11,497, [1975-76 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 80,212, was issued after the effective date of the accrual of the alleged cause of action. While the Institute contends that Section 17 does not provide a private remedy either as originally enacted or amended, such a significant expansion of the legislative scheme should not be undertaken without a thorough analysis of all appropriate sources of legislative intent particularly those related to Sections 17 and 18. In any event the releases can be no broader than the statute itself. *Hochfelder, supra* at 214.

private remedies be granted as a means of protecting broker customers. Instead, Congress sought the achievement of its purposes by strengthening the provisions for SEC oversight and for self-regulation of the securities industry:

> The intent of the bill is not to diminish the role of self-regulation but to strengthen the total regulatory fabric.

S. Rep. No. 94-75, 94th Cong., 1st Sess. 23 (1975).[11]

Further, by 1975, the SEC itself had brought numerous injunctive actions against violators of Section 17(a), one of which was brought in 1973 against Weis for the very violation alleged here. Thus, in 1975, the SEC was fully aware of the very circumstances which prompted its urging below, as *amicus curiae*, that a private remedy be implied. Nevertheless, and notwithstanding the failures of such brokerage firms and the resulting damage to customers, the SEC did not recommend that civil remedies be provided as a necessary supplement to the enforcement mechanisms

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[11] The Senate Report accompanying the 1975 Amendments (Pub. L. 94-29, 89 Stat. 137) adds, in confirming the regulatory nature of the amendments:

> [A]s the Advisory Committee on Broker-Dealer Reports and Registration Requirements recommends: '. . . for reporting purposes each broker-dealer [should] be assigned to a designated principal self-regulator or government regulator who will be responsible for determining the broker-dealer's operative and financial status.' Section 17(d) would provide the SEC with unquestioned authority to accomplish these objectives.

S. Rep. No. 94-75, 94th Cong., 1st Sess. 33 (1975).

existing under the statute. Rather, it recommended solely increased SEC oversight and self-regulatory mechanisms.[12]

Moreover, at the time these amendments were considered, two district courts had held and the Court of Appeals for the Third Circuit had affirmed that Section 18(a) contained the exclusive remedy for violations of the reporting provisions of the 1934 Act.[13] As this Court reasoned with

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[12] Moreover, the adoption by the court below of the "administrative deference" rule is misplaced. This Court in *Piper* v. *Chris-Craft Ind.*, 430 U.S. 1, 41, n.27 (1977) noted the limited value of administrative deference and specifically limited that notion in cases concerning the implication of a private right of action:

> We note, first, that the present position of the SEC is not consistent with the testimony of the SEC Chairman, in the legislative evolution of § 14(e). Even if the agency spoke with a consistent voice, however, its presumed 'expertise' in the securities-law field is of limited value when the narrow legal issue is one particularly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants. Indeed, in our prior cases relating to implied causes of action, the Court has understandably not invoked the 'administrative deference' rule, even when the SEC supported the result reached in the particular case. *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

[13] Section 18(a) was held to be the exclusive "catch-all" civil liability provision for all the reporting requirements of the 1934 Exchange Act in *In re Penn Central Securities Litigation*, 347 F. Supp. 1327, 1339-40 (E.D. Pa. 1972), *modified on other grounds*, 357 F. Supp. 869 (E.D. Pa. 1973), *aff'd*, 494 F.2d 528 (3d Cir. 1974), *Accord, duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D.Del. 1973). In concluding that Section 18(a) was the exclusive remedy for violation of Section 13(a), the court in *Penn Central* stated:

> Where Congress has specifically authorized a remedy for violation of an act, the courts should not nullify the congressional scheme by implying a right of action on behalf of those not otherwise entitled to recover. 347 F. Supp. at 1340.

Since the enactment of the 1975 Amendments, the *Penn Central* holding has been followed in seven district court cases. *Dewitt* v. *American Stock Transfer Co.*, 433 F. Supp. 994, 1005 (S.D.N.Y. 1977), *modified on other grounds*, 440 F. Supp. 1084 (S.D.N.Y. 1977) (no implied private damage action for violations of §§ 13(a)

(Footnote continued on following page)

respect to the closely related *Birnbaum* rule limiting standing to sue under Rule 10b-5 to purchasers or sellers of securities, Congress's failure to reject this interpretation "argues significantly in favor of [its] acceptance." *Blue Chip, supra* at 733.

C. The Extrinsic Evidence From the Texts of Other Sections of the 1934 Act and of the 1933 Act Show the Error of the Holding Below.

Examination of the interrelated nature of the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (the "1933 Act"), and the 1934 Act instructs that Congress did not set the boundaries of civil liability at random. See *Blue Chip, supra* at 727-30. As this Court noted in *Blue Chip, supra* at 728, in each instance where Congress imposed civil liability in 1933 Act it limited the class of plaintiffs to those who suffered a loss related to a securities transaction. The same limitation is found in Section 9(e) of the 1934 Act. The private right of action there enacted employs exactly the same transactional requirement found in Section 18(a). *Blue Chip, supra* at 736. And the "in connection with" language of Section 10(b) accordingly has been interpreted by this Court in *Blue Chip* similarly to require standing as a purchaser or seller.[14]

The decision below is thus a considerable departure from the uniformity found in the other sections of this integrated regulatory scheme as well as a judicial subversion of the terms and intent of Section 18(a) itself. It squarely conflicts with the governing decisions of this Court and should be reversed.

II.

Implication of a private right of action under Section 17(a) beyond the limitations set forth in Section 18(a) raises profoundly disturbing policy implications, provides little guidance to those who would be subject to prospective liability and is unnecessary to achieve Congressional purposes.

It is one thing to posit civil liability in damages on the basis of fraud in connection with a securities transaction. It is another to hold that anyone who Congress thought might derive some benefit from a report required to be filed with the SEC may sue under the 1934 Act for whatever damages he might incur regardless of the absence of any connection with a securities transaction. And it is quite another thing to imply such liability, not just on the part of registered brokers and companies and those persons respon-

and 15(d)); *Lewis* v. *Elam*, [1977-78 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 96,013 (S.D.N.Y. 1977) (§ 13(a)); *Levy* v. *Johnson*, [1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,899 (S.D. N.Y. 1977) (§ 13(a)); *McLaughlin* v. *Campbell*, 410 F. Supp. 1321 (D. Mass. 1976) (§§ 13(a), 20(b), 20(c)); *Meer* v. *United Brands Co.* [1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,648 (S.D.N.Y. 1976) (§ 13(a)); *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F. Supp. 213 (S.D.N.Y. 1975) *aff'd by oral opinion*, 538 F.2d 312 (2d Cir. 1976) (§ 13(d)); *In re Equity Funding Corp. of America SEC Litigation*, 416 F. Supp. 161, 190-91 (C.D. Cal. 1976) (§ 13 has ultimate purpose of investor protection; although a duty to file accurate and complete reports can be implied from the filing requirements, the "sense" of the statute and rules is that they are administrative devices and are not intended to provide private rights to investors, except as might be narrowly provided for in § 18).

[14] This Court's decision in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) is entirely consistent with the transactional limitations expressly created by Congress. There, this Court held that a recipient of a proxy statement may assert a private cause of action based on a material misstatement contained in that proxy statement in violation of Section 14(a) of the 1934 Act. Such a statement is designed, like a statement made in connection with a purchase or sale of a security (§ 10(b)) and like a statement which influences the price of a security purchased or sold by the plaintiff (§§ 9(e) and 18), to influence the receiver to act. He is thus in a position closely analogous to those whom Congress expressly empowered to sue.

sible for such reports, but on the part of auditors who are one step further removed from the registrant and who render their opinion with respect to financial statements included in such reports.

This, with respect to the reporting requirements to which every registered brokerage house and every registered company are subject, presents that stark spectacle portrayed by Chief Judge Cardozo 48 years ago and recently rejected by this Court: "a liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931), quoted in *Blue Chip, supra* at 748. Indeed, the risk of such an eventuality under the rule adopted below far exceeds the risk presented in *Blue Chip* where this court dismissed, for similar reasons, the claims under Rule 10b-5 of persons allegedly deceived into holding their securities.

Here, moreover, the exposure of auditors to potentially unlimited liability to an indeterminate class particularly should be avoided since the contours of such liability have not been established. This Court, in determining the appropriate standards of civil liability for violations of the antifraud provisions where a cause of action has been implied, has sought a firm basis for the definition of such standards in both the statutory language and the legislative history. *Hochfelder, supra* at *201.* The language of Section 17(a) and its legislative history provide no such basis to guide either the courts or those who would be subject to potential liability.[15] Thus, in holding that a private right of action

[15] For example, it is not alleged in the proceedings below that the accountants engaged in deliberate or knowing fraud, but that they were guilty of gross negligence or even recklessness. Even under Rule 10(b)-5, the issue of gross negligence or recklessness as a basis for liability was left open by this Court in *Hochfelder, supra* at 194, n.13, which gap has now been seemingly filled by the Court below in regard to Section 17 without any of the guidance from the statute sought by this Court in *Hochfelder, supra.*

exists under Section 17, the Second Circuit has planted an acorn destined to grow into a "judicial oak" at least as substantial as that which prompted the concern of this Court in *Blue Chip.*

It should be self-evident that the process of auditing the financial statements of a company does not yield absolute certitude about the result. The audit function proceeds very largely upon the exercise of judgment and by a process of sampling which in turn rests upon the experience, expertise and informed judgment of the auditor. The product of the audit, as reflected in the auditor's opinion, is again a matter of judgment. Such an indeterminate liability should not be imposed on that process.

The court below took that further step, concluding that, since "neither SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost," a private right of action against the auditors as the remaining solvent party should be implied. This conclusion misapplies the requirement of "necessity" articulated in *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), as explained in *Piper* v. *Chris-Craft Ind.,* 430 U.S. 1, 25 (1977) (emphasis supplied):

> The reasoning of these holdings is that, where congressional purposes are likely to be *undermined* absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute.

This principle was reaffirmed in *Santa Fe Industries, Inc.* v. *Green, supra* at 477:

> . . . we have also recognized that a private cause of action under the antifraud provisions of the Securities Exchange Act should not be implied where it is 'unnecessary to ensure the fulfillment of Congress' purposes' in adopting the Act.

Section 17(a) is not an antifraud provision nor was it enacted for the broad remedial purposes which this Court has attributed to the antifraud provisions. To be sure, Section 17(a) was enacted for the ultimate purpose of protecting investors. But it does not follow that an implied right of action is "necessary" to effectuate that purpose. The reporting provisions and the net capital rule, 17 C.F.R. § 240.15c3-1, are designed to prevent broker failures and to keep the SEC, as well as customers, apprised of the financial status of brokerage firms. H. Rep. No. 91-1613 91st Cong., 2d Sess. (1970). Together they provide an early warning system to alert the SEC to the financial status of brokers in order that measures might be timely taken to ward off financial collapse. To enforce these provisions, the courts are empowered both to enjoin violations and to impose criminal penalties for violations. 15 U.S.C. §§ 78u(e), 78aa. The deterrent value of the threat of damage awards over and above the sanctions presently provided for is speculative at best. *Cf. Piper* v. *Chris-Craft Ind., supra* at 40. Denial of relief to broker's customers under Section 17(a) will not "undermine" Congress' purposes; nor would granting such relief ensure the fulfillment of those purposes.

Moreover, no explanation is given for the creation of a federal remedy, and its concomitant burden on the federal courts, in view of the state law remedies noted in the dissenting opinion of Judge Mulligan. Plaintiffs, in fact, commenced an action for damages in the state courts of New York prior to the commencement of the federal action. No additional federal remedy is necessary to redress their alleged injuries and "[t]he result would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation." *Santa Fe Industries, Inc.* v. *Green, supra* at 478.

The holding below goes far beyond improvidently permitting a private cause of action under Section 17(a) in order to allow redundant recourse in a federal court to a presumed "deep pocket." It nullifies at the same time the carefully balanced enforcement scheme based on industry self-regulation, SEC oversight and enforcement, and explicit private remedies enacted and intended by Congress. The holding below was error and should be reversed.

CONCLUSION

For the foregoing reasons, the order of the Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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